

Survey of the Czech Economy and MIT Sectors in 2007



June 2008

Issued by the Ministry of Industry and Trade of the Czech Republic
Editor: Ivo Hering – Phone 420 2 2485 3544, Fax 420 2 2485 2404
English translation: Mgr. Radek Skarnitzl
Prague, June 2008

CONTENTS

LIST OF ABBREVIATIONS	5
INTRODUCTION	7
SUMMARY OF TRENDS IN THE ECONOMIC DEVELOPMENT IN 2007	11
I. MAIN TRENDS OF THE MACROECONOMIC DEVELOPMENT	19
I.1. Performance of the economy	19
I.2. Structure of the economy	22
I.3. Labour market	24
I.4. Price and fiscal policy	32
I.4.1. Price policy	32
I.4.2. Fiscal policy	36
I.5. Monetary policy and foreign direct investments	39
I.5.1. Monetary policy	39
I.5.2. Foreign direct investments and its support	47
I.6. Capital market	50
I.7. Results of the financial management in non-financial sector	55
II. INDUSTRY	59
II.1. Production, employment and productivity	59
II.2. Financial situation of industrial enterprises	74
III. CONSTRUCTION	79
III.1. Production, employment and productivity	79
III.2. Housing Construction	83
III.3. Financial situation in the construction	84
IV. FOREIGN TRADE	86
IV.1. Summary results	86
IV.2. Territorial Structure	90
IV.3. Commodity Structure	92
V. INTERNAL TRADE AND FINAL HOUSEHOLD CONSUMPTION	96
V.1. Trade Sector	96
V.2. Final household consumption	100

Annex

The Analysis includes data as at 30 March 2008.

LIST OF ABBREVIATIONS

BFI	Business Future Index
BLS	Bureau of Labor Statistics USA
BUX	Index of Hungarian stock market
CAC 40	Index of French stock market
CCA	Czech Consolidation Agency
CZSO	Czech Statistical Office
DAX	Index of the FRG stock market
IIT	Individual Income Tax
CIT	Corporate Income Tax
ECB	European Central Bank
EIB	European Investment Bank
EMU	Economic and Monetary Union
Fed	Federal Reserve System (USA)
FTSE	Index of United Kingdom's stock market
Gfk	Institute for market research, Prague
HICP	Harmonized indexes of consumer prices
HI-TECH	Technically sophisticated products
HPH	Gross value added
ILO	International Labour Organisation
IPI	Index of industrial production
M ₁	Circulating money + overnight deposits
M ₂	Total money supply
MIT	Ministry of Industry and Trade
MLSA	Ministry of Labour and Social Affairs
NACE	Statistical classification of economic activities in the European Community
Nasdaq Composite	Index of the American, electronic-screen based Stock Exchange
OECD	Organisation for Economic Cooperation and Development
OPEC	Organisation of Petroleum exporting countries
p.p.	Percentage point
PPS	Purchasing Power Standard
PSE	Prague Stock Exchange
PX	Major index of the Prague Stock Exchange (formerly PX 50)
PXE	Prague Energy Exchange
PX-GLOB	The overall index of Prague Stock Exchange
RM	Index of RM-System (formerly PK-30)
RM-S	RM-System - electronic-screen based Stock Exchange
SAX	Index of the Slovakian Stock Market
S&P 500	Index of the U.S. Stock Market
SC	Securities Centre
SITC	Standard International Trade Classification
SPAD	Support system for stock and bond markets
TB	Treasury Bills
TPCA	Toyota Peugeot Citroën Automobile
BVA	Book value added
LFS	Labour Force Survey
WIG	Index of the Polish stock market

INTRODUCTION

The development trend of a strong economic activity of the Czech economy continued in 2007. After the growth of 6.4 % over the previous two years, **the performance of the economy, figured out in the Gross Domestic Product in real terms increased year-on-year by 6.5 %** and thus achieved a record-breaking level in the modern history of the Czech Republic. On the supply side, its growth was most encouraged by the manufacturing industry; on the demand side, in particular, by the household expenditures on final consumption.

With the dynamics achieved, the **Czech Republic ranked among the fastest growing countries** in Europe. Only the Baltic republics, and especially Slovakia, which reached its best outcome of the 10.4 % growth, grew faster. **The Eurozone as a whole grew by 2.6 %**, which, in terms of advanced European economies, is still strong momentum with the positive impact on the outlets of the Czech exports. During the year, however, the economic development of the Eurozone slowed down.

A higher dynamics in the economic growth in the Czech Republic, in comparison with the Eurozone, namely with the European Union (which reached 2.9 % growth), led to the **strengthening of its international economic position** characterized by the volume of the Gross Domestic Product per capita. According to the preliminary calculations of the Czech Statistical Office, the Czech Republic already reached 82 % of the average level of the EU-27 in this indicator (in purchasing power parity) in 2007 (79.3 % in 2006, according to the Eurostat).

As regards the **internal conditions** of the Czech economy, relatively low and stable inflation retained only at the beginning of the year. Since the end of the 1st quarter **consumer prices** increased gradually with fewer fluctuations, and progressively from September to the **5.4 % year-on-year increase in December**. Their acceleration occurred, in particular, after the impact of administrative measures was added by a growth in the prices of food and energy. On the other hand, the strong Czech currency had the anti-inflation effect. The accelerating pace of price growth lifted up the domestic inflation above the level of the EU countries, so that the Czech Republic belonged among the countries with the fastest growing inflation rate (about 2.3 p.p. above the EU average in December).

An acceleration in the price developments during the year resulted in the level of the real household expenditures for the final consumption. While for the entire year **the household**

consumption increased by 5.7 %, its growth in the 4th quarter was only 4.0 %. Despite the slowdown in the consumption at the end of 2007, the year-round result represented the highest growth over the last four years, while a higher domestic demand was stimulated, in particular, by the employment growth and a higher income of the population (the average nominal wage increased year-on-year by 7.1 %). In particular, due to higher health insurance costs the **final consumption of the government also year-on-year increased, namely by 0.9 %**.

The role of the main source of the economic growth is being gradually taken over by the investments. The **expenditures on the gross fixed capital formation increased year-on-year by 6.1 %**, which was the highest increase over the past six years (in the 4th quarter of 2007 the capital expenditures as well as the final consumption of households contributed to the economic growth by 2.0 p.p.). The investments in transport equipment (8.6 %) and in machinery and equipment (7.9 %) increased most.

The external sector also contributed to the Gross Domestic Product growth, when a **growth trend of the real export of goods and services (14.5 %) continued to overpace** that of imports (13.7 %). This development shows the good export condition of the Czech economy, but also its large import intensity. A prevalence of the exports over imports resulted in the **record-breaking trade surplus** (85 billion CZK in current prices), which was more than doubled against the year 2006. The Czech Republic at the same time, as a single from the new European Union member states, showed a positive balance of the foreign trade.

The **trade exchange with the countries of the European Union** successfully developed and its proportion in the total turnover amounted to 78.2 %. The surplus in trade with the European Union reached nearly 415 billion of CZK and covered high deficits with the countries outside Europe (174 billion of CZK), CIS (63 billion of CZK) and developing economies (53 billion of CZK). From all countries **Germany** retained the position of country's largest trading partner (30.8 % of domestic exports) before **Slovakia** (with a share of 8.8 %).

As for the **commodity structure of exports, machinery and transport equipment** strengthened its dominant position and their share in the total exports reached 54.2 % (though, the level was at 30 % in the mid-nineties). Within the balance of the machinery the export increased by 17.4 % year-on-year and the surplus (which reached 312.5 billion of the Czech crowns) by 41.5 billion CZK. On the other hand, the overall trade balance was negatively affected, in particular by the **trade deficit with mineral fuels**, despite it decreased in

a consequence of the reduction in import prices from 139 billion of CZK to 124 billion of CZK on the year.

The year-on-year current account deficit dropped (to 2.5 % of GDP), while continuing growth in the balance of performance (with a higher surplus in the balance of goods than services) was sufficient of almost 70 % to compensate for the progressively increasing income balance (in the current worsening of the negative balance of the current account transfers). Despite the stagnation of the influx of resources in the financial account (2.9 % of the GDP) the **result of the general balance of payments was positive** (15.7 %, i.e. 0.9 billion of USD).

On the supply side of the economy, the industrial production **increased year-on-year by 8.2 %**. In comparison with the year 2006, it came to some slowdown (index of industrial production reached 11.2 % in 2006), but this trend was accompanied by the desired changes in favour of the "lightening" production structures, described in particular by the rapid growth of the industries with a higher value-added (automotive, electronic and computer industry).

More than a half of the industrial output was focused on the **export** in the last year, a proportion of the manufacturing industry itself, was even higher (by about 60 %). The use of production for export has been accelerating rapidly, as evidenced by a comparison with the year 2000, when the revenues from direct exports participated in the total industrial sales by only slightly above the third (37.5 %). Mainly the **exports of cars and their accessories and office machinery and computers** were increasing.

In view of the continued growth of the industrial competitiveness, a favourable trend in **labour productivity growth** proceeded further in the **outpacing that of wages**. While the average real wages in the industry increased by about 4.5 % in the last year, a labour productivity increased by 6.6 %. This result was achieved while **employment grew by 1.8 % in total and by 2.2 % in the manufacturing industry**. Less favourable is the fact that the employment growth slowed down in the second half of the year (in the manufacturing industry to 1.7 %) mainly due to a growing tension in the labour market. A lack of the personnel in certain professions, especially technical in the middle and higher level of competence, but also workers of service operations and auxiliary staff was becoming increasingly apparent.

The construction output grew by 6.7 % with the result that during the year its development showed large fluctuations. This uneven development, including, in particular, a rapid growth in the 1st quarter of the year, coincided with the particularly favourable

conditions due to a mild winter (as well as the low comparative base in early 2006). Large developers building projects for the **construction of industrial and administrative centres** and continued strong housing construction associated with the highest growth rate of the completed dwellings since 1991, were the main factors of the development. Like in the industrial manufacturing, also in the construction industry a lack of the required professions, which could become a barrier to a further growth of the sector, is being perceived.

These structural weaknesses in the supply of labour force weakened an overall positive trend in the labour market, which was characterized by the increasing employment and reducing unemployment. The **year-on-year number of workers in the national economy increased by 1.9 %** (to 4.9 million). The **average year-on-year unemployment rate fell to 6.6 %**, i.e. by 1.5 p.p. year-on-year and was the lowest since 1998. The acceleration occurred in the development of wages, when an average wage increased by 7.1 % (in real terms by 4.2 %).

A higher employment and rising income of the population at the same time encouraged the domestic demand for goods and services. This is evidenced by the amount of the **seles in the internal market, which increased year-on-year by a record-breaking 7.7 %**. There were also other factors involved in its expansion, such as the growing tendency for consumption (supported by the access to credit products, but also by the announced raising of the cost of living in 2008), the fight for customers between strong trading companies and an attractive offer. The seles have continued to grow for nine years and the increase in 2007 was the highest one in the whole time methodically comparable series.

SUMMARY OF TRENDS IN THE ECONOMIC DEVELOPMENT IN 2007

I. Macroeconomic development

- **The Czech economy grew by 6.5 % in 2007**, which is the best result in its modern history. The growth above the 6 %-level has continued for the eleven quarters in a row **reaching as much as 6.6 % in the 4th quarter** of the last year.
- A main source of the growth in real Gross Domestic Product was the domestic demand, same as in 2006. **The households consumption expenditures in real terms increased year-on-year by 5.7 %**, in particular with regard to the developments in the labour market (described by the employment growth and increasing income of the population). **The government expenditures increased year-on-year by 0.9 %** (after its stagnation in 2006).
- Also a growth of the **fixed capital formation** accelerated, when **increased by 6,1 %** after the year-on-year growth of 5.5 % in 2006. The investments in transport equipment (8.6 %), followed by machinery and equipment (7.9 %), housing (7.2 %) and investments to other buildings and structures (4.8 %), were growing fastest.
- The foreign trade resumed the four-year **trend of a faster growth of exports of goods and services at constant prices (14.5 %) than their imports (13.7 %)**. The active balance of the foreign trade (in current prices) increased year-on-year by 66.3 billion of CZK to 165.9 billion of CZK.
- The **manufacturing industry contributed most to a growth of the gross value added** on the supply side of the economy (3.0 p.p.), a contribution of the trade, catering and transport (which in total contributed by 2.5 p.p.) and finance and services for businesses (1,7 p.p.) was also significant. On the other hand, the year-on-year decline in the gross value added occurred in the agriculture and energy industry.
- **In the sectoral structure of gross value added** (at current prices), a share of the industry increased to 32 % (from 31.7 % in 2006), and solely due to the **manufacturing industry** (the share of which rose year-on-year by 0.8 p.p. to 27.5 %). A proportion of the **gross value added in the agriculture** increased to 2.8 % (from 2.6 %), while the share of **the construction industry** stagnated (6.4 %). A share of total **services** decreased to 58.8 % (from 59.3 %).
- When employment grew by 1.8 %, **the national labour productivity increased** (gross domestic product per worker) by **4.6 %** (in 2006 by 4.4 %). For the four years in a row a favourable trend in faster pace of the productivity growth ahead of the wages growth (in 2007 this was ahead by 0.4 p.p.) continued.
- The economic expansion resulted also in the **development of economic structures**. The year-on-year increase in the number of registered economic entities (2.1 %) was the highest over the last four years, especially a number of the registered legal entities increased significantly (by 6.8 %).
- At the end of the year **a number of population reached 10 381 100 of inhabitants**, while **increased year on-year** by 93.9 thousands. An increase in the population was influenced mainly by the positive balance of foreign migration (83.9 thousands) but also by the natural increase of population (10 thousands).
- **A number of economically active persons (labour force)** decreased slightly by 1.1 thousand to 5 198 300 of people. **A level of the economic activity**, i.e. a proportion of the economically active persons in the overall number of persons older than 15 years decreased year-on-year by 0.5 p.p. to 58.8 % and, on the contrary, an **employment rate**, i.e. the proportion of the number of people with the sole or main occupation out of the number of persons older than 15 years, with an growing number of workers rose by 0.6 p.p. to 55.6 %.
- **A number of workers in the national economy**, in a single (main) job, **according to the selected survey** of the Czech Statistical Office increased by 93.9 thousands p.a., i.e. by 1.9 % to 4 922

thousands of people. Employment increased in the secondary sector (industry, construction) by 49.9 thousands to 1 979 300 and by 49.4 thousands to 2 766 400 of people in the tertiary sector (services) and fell in the primary sector (agriculture, forestry, fishing) by 5.4 thousands to 176 300 of people.

- A total **number of the foreign nationals employed** in the Czech Republic increased year-on-year by 55.2 thousands to 240 200 of people as of 31 December. A number of the **registered persons in the structure** of those who do not need permission to work, including foreigners, increased by 31.3 thousands to 154 900 and, at the same time a number of **work permits** granted to foreigners from the third countries **increased** by 23.9 thousands to 85 400 of people.
- A number of foreigners, **working as entrepreneurs on the basis of the trade license** increased year-on-year by 3.1 thousands to 68.8 thousands people as of December 31. **An overall number of entrepreneurs**, registered in the Czech Republic as a natural and legal persons, reached 2 054.3 thousands at the end of the year, when year-on-year increased by 23.6 thousands of people (1.2 %).
- **A registered unemployment rate** showed a significant decline during the year **reaching** 6 % (by 1.7 p.p. less than a year ago) as of 31 December. The year-on-year average decreased by 1.5 p.p. to 6.6 %. **A number of the job seekers** fell by 93.7 thousands, i.e. by 26.4 % to 354.9 thousands at the end of the year. **A number** of the unemployed **women** decreased by 47.6 thousands to 191.2 thousands, but their share in the total number rose by 0.7 p.p. to 53.9 %.
- The labour market showed 141.1 thousands of **job vacancies** as of December 31 (by 47.6 thousands more than in the previous year). One vacancy accounted for 2.5 candidates at the end of the year (a year ago - 4.8). With the improving situation in the economy, increasing job vacancies in some enterprises began to show a lack of the personnel, particularly technical professionals in the middle and higher level of competence.
- Candidates over 50 years **in the structure** of the unemployed remained a vulnerable group, whose proportion in the total number of candidates increased year-on-year by 3.5 p.p. to 30.6 % followed by the applicants with disabilities, with a low education and mothers with children.
- **The average monthly nominal wages of employees in the economic entities of business sphere with 20 employees or more** (in the finance and insurance companies regardless of the number of employees) and in all spheres of the non-business organizations increased by 7.3 % to CZK 21 692 and **real wages increased year-on-year** by 4.4 %. The average **nominal wages of employees in the national economy** (including estimates for small businesses) **increased** by 7.1 % to CZK 20 333, and **real wages** by 4.2 % year-on-year. A wage demand of the GDP reached 28.4 % and was by 0.3 p.p. lower than in the previous year.
- A relatively low and stable inflation from the previous years held on only at the beginning of 2007. In the coming months the **consumer prices**, on the contrary, started to rise more progressively than in the recent years. A main acceleration occurred in November and December (by 5.0 %, respectively. 5.4 % year-on-year), afterwards the impacts of the administrative measures were added by an increase in the price of food and energy, and culminated in January 2008 by the year-on-year value of 7.5 %.
- The average **inflation rate** (moving average for 12 months) was falling since January, stagnated at 2.0 % in August and September, changed the trend from October and rose to 2.8 % in December and to 3.4 % in January 2008.
- **Prices of the industrial producers** increased substantially during 2007 (from 2.6 % at the end of 2006 to 5.2 % in December 2007 and to 6.0 % in January 2008), with a slight dynamics slow down in August, mainly due to a temporary drop in the prices of oil. The year-on-year growth of prices of industrial products was the highest for the last three years and was primarily driven by the price increases in the sectors of coal, lignite, peat, oil (in average by 8.8 %), energy, gas and water (in average by 7.4 %), basic metals, metallurgical and metal products (in average by 6.7 %).

- **Import prices** in the course of 2007 held on (with the exception of June and July) below the previous year's level (in December by 1.3 %) and afforded conditions for a weakening of the external cost pressures on the growth of the domestic prices.
- **Prices of the construction works** even further accelerated its progressive rate of growth during 2007 (from 3.2 % in December 2006 to 4.4 % in December 2007 and 4.6 % in January 2008).
- **Prices of the agricultural producers** held on mostly a double-digit growth throughout the year 2007 and their gains took up even greater pace in the second half of the year by reaching 26.6 % in December and 26.9 % in January 2008.
- In contrast to the developments in the previous price lines, the **prices of market services** in the **production sector** decreased significantly the growth rate in 2007, from the average for 2006 of 3.2 % to 1.6 % in 2007 (when, in January 2008 increased once again by 2.9 %).
- **Management of the Treasury** ended with the deficit of 66.39 billion of CZK in 2007, which was by 24.9 billion of CZK lower than foreseen by the law approved budget (compared to the year 2006 there was a better outcome of 31.2 billion CZK). Revenues amounted to 1 025.88 billion of CZK, expenses 1 092.27 billion CZK.
- **Management of the local government units** - regions, municipalities and voluntary associations - showed a surplus of 9.4 billion CZK (budget foresaw a deficit of CZK 6.7 billion) due to the lower expenses. A crucial part of the surplus of 8.3 billion of CZK was generated by municipalities and the DSO, the regions accounted for 1.1 billion CZK.
- **Management of the public budgets** (including net lending) improved significantly, and, with the 35.9 billion of CZK deficit reached roughly a quarter deficit declared in 2006. The total revenues amounted to 1 375.7 billion of CZK, expenses to 1 411.6 billion CZK.
- A long-term trend of the growth of the **government debt**, launched in 1997, continued in 2007 (year-on-year by CZK 89.9 billion) and increased to 892.3 billion of CZK. The net internal debt balance rose by 88.5 billion of CZK and external debt balance by 1.4 billion of CZK. Consequently a **debt of public budgets** increased (by CZK 95.5 billion) and reached 973.2 billion of CZK by the end of 2007, representing 27.4 % of GDP.
- **The money stock** (M2 aggregate) returned to the double-digit growth in early 2007, which peaked in December (by 13.2 % i.e. 2 478.3 billion CZK). A double-digit dynamics of growth of the **M1 money aggregate** further increased (in December by 16 % to 1 438.6 billion of CZK) after the transitional slowdown in the 3rd quarter, and corresponded to the development of the year-on-year rates of growth of **overnight deposits** (in December increased by 18 % to 1 114.6 billion Czech crowns) for households and businesses. Also a volume of the **currency** further increased (in December by 9.8 % to 324.1 billion of CZK) and the high dynamics of growth culminated in May (by 13.4 %).
- A pace of **credit growth for the businesses**, which has been achieving the double-digit levels since the two and a half years continued to grow intensively (in December by 21.1 % to 902.4 billion of CZK). The year-on-year growth in lending to households, which, at the turn of 2006 and 2007, fell below the level of 30 % in a short-term, was gradually accelerating in the course of the year (in December by 34.3 % to 726.3 billion of CZK).
- **The Czech crown** followed especially the developments of the Euro-dollar market, movement of currencies in the Central European region and the global flow of the venture capital. Its movement was not always clear over the course of the year, however, it was continuing in the long-term trend of appreciation, which peaked on 10th December by reaching a new historical maximum, both against the Euro (exchange rate: 26,000 CZK / EURO), and the dollar (exchange rate: 17,662 CZK / USD). The year-on-year average of the evaluation of the CZK amounted to 2 % against the Euro and 10.2 % against the dollar for the year 2007.
- An aggregate result of the **balance of payments** was positive for the year 2007 (15.7 billion CZK, i.e. 0.9 billion USD), and was afforded mostly in the 4th quarter, when, after the insignificant active

balance in the first and in the second quarter, foreign transactions in the second quarter required an involvement of the foreign exchange reserves. In view of the lasting stagnation of the influx of **financial** resources on the **account** (104.5 billion CZK, i.e. USD 5.4 billion and 2.9 % of the GDP), this result was generated by the decline in the **current-account** deficit (89 billion CZK, i.e. 4.5 billion USD and 2.5 % of the GDP), by the growth of the active balance in the still less significant **capital account** as to the volume, (19.7 billion CZK, i.e. USD 1 billion) but also by the growth of the negative balance of foreign exchange rate differences, errors and omissions (19.5 billion CZK, i.e. USD 1 billion).

- **Foreign exchange reserves** of the Central bank during 2007 largely decreased to CZK 631 billion as of December 31, 2007 (year-on-year decreased by 25.6 billion). But on the contrary, in dollar terms, due to the exchange rate movements, they increased to 34.9 billion USD (by about 3.4 billion USD). They covered 2.9 monthly imports of goods and services and thus remained just below the three-month coverage, which is considered safe. In the following period, foreign exchange reserves also dropped and at the end of February amounted to CZK 615.5 billion.
- **Gross foreign debt** proved the long-term growth trend and increased to CZK 1 348.8 billion (74.6 billion USD) as of 31 December 2007. A level of the foreign debt represented 37.9 % of the GDP (at the end of 2006 it was 36.9 %) and thus continued to remain below the generally accepted "safe" limit of 40 %.
- **Influx of foreign direct investments rose year-on-year by 36.4 % in 2007 and reached CZK 185.3 billion, i.e. USD 9.3 billion.** In doing so, reinvested earnings amounted to CZK 130.6 billion (USD 6.4 billion), investments in the basic capital accounted for CZK 57.5 billion (USD 2.8 billion) and other capital accounted for CZK -2.8 billion - its decline was influenced by the payments of obligations to the foreign parent companies.
- **Most of the FDI came from the EU countries**, most of the Netherlands (CZK 53.4 bill.), from Luxembourg (CZK 23.8 bill.), Austria (CZK 21.7 bill.), France (CZK 19.9 billion) and Germany (CZK 15.4 billion); from outside of the EU: the Republic of Korea (CZK 7.9 bill), United States (CZK 7.0 bill.) and Japan (CZK 5.0 bill). They were bound especially to the real estate and services for businesses and for the financial intermediation.
- **The FDI reflux from the Czech Republic in 2007 decreased year-on-year by 18.4 % and amounted to CZK 27.1 billion, i.e. USD 1.4 billion**, out of which investments of CZK 10.5 billion were intended for the reinvested earnings, other capital amounting to CZK 11.0 billion and CZK 5.6 billion accounted for the basic capital.
- In 2007, the **Ministry of Industry and Trade decided on Investment Incentives for 55 companies** in the overall scale of investment of CZK 30.9 billion and with an estimated number of 7 342 of newly afforded jobs.
- **MIT also decided to support the 57 projects of technological centres** with a total estimated investment of 6.3 billion and 4 131 new jobs and gave support to the **56 projects of the strategic services centres** with an investment of CZK 13.6 billion and 16 147 newly afforded jobs in 2007.
- The year 2007 was full of extremes on the **Prague Stock Exchange**, which, like other Central European stock exchanges, followed the developments in major markets. The **PX index** grew and showed the extraordinary results. The December closed on the value of 1 815.1 points, which is the year-on-year increase of 14.2 % (for January, however, depreciated by 17.4 %), with the year-on-year minimum of 1 565.3 and a maximum of 1 936.1 points.
- **Financial results of the non-financial sector (flow indicators) in organizations with 50 or more employees developed as follows:**
 - **Book value added** (in current prices.) increased by 11.3 %, most in services (12.8 %), in construction (12.2 %), agriculture, forestry and fishing (11.2 %) in industry (11.1 %), trade (10.6 %), transport, storage and communication (9.9 %) and accommodation and catering (3.6 %).

- **Labour productivity from the book value added** (in current prices.) increased by 8.2 % to CZK 716.6 thousands per employee, when the employment grew by 2.9 %. The highest level is still in the industry (810.8 CZK thousands per employee.), which increased by 9.1 %, the lowest in agriculture, forestry, fisheries (CZK 368.2 thousands per employee) with the year-on-year growth of 19,6 %.
- **Performance including the business margin** increased year-on-year by 9.9 %, the **power consumption** by 9.4 %. A faster growth in the output than in the intermediate consumption was characterized for the most sectors, except for business services and accommodation and catering.
- **Enterprises in the sector under foreign control** strengthened its position on the results of the non-financial sector and reached the following proportions: 39 % share in the jobs, 55 % share in the performance and 51 % share in the book value added. Their labour productivity from the book value added (in current prices.) increased by 7.7 % while employment by 11 %.

II. Industry

- **The main characteristics of the production in industrial organizations with 20 employees or more:**
 - **Industrial production increased by 8.2 % in 2007** (the year-on-year slowdown in the growth of 3 p.p. was due to a lessening of the growth of the economies in the EU countries and a high comparative base of the previous year). A dynamic growth of the production was generated by the manufacturing capacity of **foreign investors and by the commencement of new production capacities**, particularly in rubber and plastics industry, mechanical engineering, electronic and computer and automotive industry, which has been driven by high demand. **The sales (in constant prices) increased by 9.3 %** and exceeded the growth of production, revenues from the direct exports (in constant prices) rose by 13 % (with 56.2 % in the overall revenues in industry).
 - In the breakdown by **main industrial groupings, production for the long-term consumption** showed the largest growth of 17.7 % (increased customers demand supported by growth in revenues). The continuing investment activity in the economy was resulted in an increase in **production for the investments** in the amount of 14.4 %.
 - **Manufacturing industry was the key holder of the growth**, under which the **companies under foreign control** showed a high performance. The output increased by 8.9 %, sales by 9.9 % (in constant prices) and revenues from direct exports (in constant prices) by 12.9 % (participated by 55.5 % in total receipts from the sale of own products and services of the industry, by 59.9 % in receipts from sales in the section). A high rise was noted, in particular, in the **production of rubber and plastic products** (by 19.7 %), **production and repairs of machinery and equipment** (by 17.5 %) and **production of electrical and optical equipment** (by 15.7 %).
 - A development of the concluded **contracts in total** resulted in slowing down the growth dynamics in the industry. The newly concluded **contracts** (60 % share in the total industry revenues) increased by 9.8 % (9.9 p.p. year-on-year reduction in growth), out of which procurement from abroad amounted to 11.8 %, receipts from sales in selected sections (in constant prices) were higher by 11.6 % (a reduction in growth of 1.1 p.p.). A growth in the total orders showed a slowdown in the dynamics of the industry.
 - **Manufacturing industry further strengthened**, its share in the total industry sales increased to 92.6 % (year-on-year increase of 0.5 p.p.), while the remaining sections of energy to 5.5 % (by 0.3 p.p.) and raw materials to 1.9 % (by 0.2 p.p.) declined.
 - New investments, the ongoing structural changes and continuing high demand (especially foreign) resulted in the **employment growth in the industry** (since mid-2005 the absorption of the workforce for selected industries has been increasing) by 1.8 %, in the manufacturing industry itself by 2,2 %.

- A growing volume of the industrial production and sales, even under the increased overall employment, resulted in the **growth in labour productivity** (in constant prices) by 6.6 %, out of which the manufacturing industry accounted for 6.7 %, the raw material section for 3.6 % and the energy section for 3.4 %. This positive development has enabled businesses a faster growth of the **average nominal wages**, which grew by 7.4 %.
- **Real wages were by 4.5 % higher** when converted to the index of consumer prices and by 3.2 % higher as per the industrial producer price index. A **growth in the labour productivity overpaced the dynamics of growth in real wages** by 3.4 p.p. (converted by industrial producer price index), respectively by approx. 2.1 p.p. (when converted by index of consumer prices). A higher growth in the nominal wages than in labour productivity impacted on the increase of nominal unit costs by 0.8 %, while the real ones fell by 3.2 %.
- **In the size structure**, organizations with 3000 - 3999 employees reached the highest **sales growth** of approx. 35.8 % (in constant prices), while increasing their contribution in the overall sales from 1.5 p.p. to 5.6 %). They showed also a high growth in employment in the amount of 15.1 %. In this size group, in particular, the private enterprises under foreign control from the successful sectors with very good export opportunities, which showed a high growth of the direct exports by 60.7 % operate there.
- In the structure of industrial enterprises broken down by **institutional sectors**, a high performance of the private enterprises under foreign control continued in the growth of sales (in constant prices) by 12.5 %, while increasing their share in the total revenues to 60.2 % (year-on-year by 1,6 p.p.). Their number increased almost twice between 2000 and 2007 (to 2093 enterprises) and their share by more than one third (to 60.2 %).
- **Flow indicators in the organizations with 50 or more employees developed as follows:**
 - **Book value added** (in constant prices) increased by 11.1 %, most in the manufacturing industry (by 14.5 %), mining of raw materials by 2.7 %, while in the energy section decreased by 2 %.
 - **Labour productivity from the value added tax** (in constant prices) increased by 9.1 % while the employment grew by 2 %. It grew most in the manufacturing industry (11.7 %), where employment grew by 2.6 %. In the energy sector, productivity increased by 1.2 % and employment fell by 2.8 %.
 - **Performance** including the business margin (9.2 %) outpaced the growth in **the intermediate consumption** (by 8.6 %), while the energy output increased by 4.1 % and intermediate consumption by 6 %, the manufacturing industry's output increased by 10.3 % and intermediate consumption 9.1 %.

III. Construction

- In 2007 the construction industry resumed in the dynamic development and its production **accelerated the year-on-year rate of growth** to 6.7 % (in constant prices). The extensive development construction projects for the construction of **industrial and administrative centres and continued strong housing construction** were the main sources of the growth.
- The production characteristics of the construction enterprises **with 20 employees or more**, shows that:
 - **Construction work** (in constant prices) **showed the year-on-year growth** of 5.8 % while its share in the production of the sector amounted to 68.7 %. New construction, reconstruction and renewal increased by 5.7 % and repairs and maintenance decreased by 2.8 %.
 - **Construction work abroad increased** in a high rate of 51.6 % (while the share of 3.5 % in the total volume of the construction work was low).
 - **Labour productivity increased by 7.5 % while the employment declined by 1.5 %.**

- **A growth in labour productivity overpaced the average monthly growth of real wages** (when converted to price index of construction work) **by 3.7 p.p.**
- **A number of building permits issued rose year-on-year by 13.3 %** to 117 384, the **indicative value of permitted construction dropped by 0.9 %** to 357.7 billion CZK.
- A housing construction in 2007 was **described by a record-breaking increase of completed dwellings (38.0 %) accompanied by a stagnation in the opening construction of new flats (0.1 %)**, which positively impacted on the **declining dynamics of unfinished and partially built construction (1.3 %)**, when the total number of started dwellings still exceeded the number of dwellings completed.
- **Flow financial indicators in the organizations with 50 or more employees** (involved with more than a half in the total construction output) developed as follows:
 - **Book value added** (in constant prices) increased by 12.2 %, under a faster growth in the **output (8.4 %)** than in the **intermediate consumption (7.6 %)**.
 - **Labour productivity from the value added** (in constant prices) increased by 14.3 % to CZK 669.5 thousands per employee, under the decline in employment by 1.9 %.

IV. External trade

- **Foreign trade in goods**, which reached a record-breaking 85 billion of CZK, ended in surplus for the third year in a row (i.e. the year-on-year increase of 45.2 billion of CZK). The turnover amounted to CZK 4 859.7 billion, of which CZK 2 472.4 accounted for the exports and CZK 2 387.4 billion for imports. The dynamics were two-digit, exports exceeded imports by 1.9 p.p. (15.3 % to 13.4 %).
- **The terms of trade performed favourably** as a result of the growth in export prices (by 1.3 %), while import prices declined (by 1 %), and reached an average of 102.3 for the entire year, representing the year-on-year improvement of 3.8 points. It affected the trade surplus in the range of 61 %. **In constant prices**, the rate of growth was faster than in current prices, imports rose year-on-year by 14.9 % and exports by 14.3 %.
- **Value results in Czech crowns were influenced both by the strengthening of the CZK to the dollar and Euro** (by 10.2 % respectively 2 %). Therefore, the dynamics of exports and imports expressed in U.S. dollars were significantly higher than in the Czech crowns (exports increased by 28.7 %, imports of 26.6 % in USD). The pace of exports and imports was only slightly higher in Euro than in the Czech crowns (17.8 % respectively 15.9 %). Exports reached USD 122.4 billion (EURO 89.1 billion) and imports USD 118.3 billion (EUR 86.1 billion). A positive trade balance amounted to USD 4.1 billion (EURO 3.1 billion), which was the year-on-year improvement in the amount of USD 2.4 billion and EURO 1.7 billion.
- Total **exports** increased year-on-year by 327.8 billion CZK, growing to all territorial areas, but in a different pace. The increase in exports accounted for the **advanced market economies** in the amount of 86 %, despite the fact that their share slightly impaired to 91.1 %. **An increase in imports**, which amounted to CZK 220.9 billion originated from advanced market economies from the three-fourths. Due to a robust growth in imports from China, imports from **countries outside Europe** achieved the highest dynamics (44.2 %).
- **The total amount of the total trade balance surplus** (CZK 85 billion) was mainly influenced by the growth of a surplus with the advanced market economies, particularly with the EU (by CZK 71.7 billion to 414.7 billion). This **positive balance covered the high losses** mainly in trade with countries outside Europe (deficit reached 173.6 billion Czech crowns), the CIS (CZK 63.3 billion) and the developing economies (CZK 52.7 billion).

- **Machinery and transport equipment** strengthened a dominant position with the volume of 1 339.9 billion CZK in exports as a result of the year-on-year growth of 17.4 %. Imports increased by 18 % to CZK 1 027.3 billion. A proportion of exports strengthened by 1 p.p. to 54.2 % and imports by 1.6 p.p. to 43 %. A positive balance increased by CZK 41.5 billion to CZK 312.5 billion. In contrast, a significant **worsening in the balance**, reducing the surplus from CZK 16.7 billion to CZK 4.3 billion, was showed by the **market products**.
- **The highest deficit** arose in the **mineral fuels, lubricants and related materials**, even though it decreased year-on-year by 15 billion to 124 billion CZK. This reduction was primarily caused by the decline in import prices of fuels, in average for the entire year by 1.3 %. The second highest passive balance accounted for **chemicals and related products** increased year-on-year by 14.7 billion to 103.8 billion CZK. A trade deficit of the **food** increased by 2.8 billion to 29.8 billion CZK.

V. Internal trade and final consumption of the households

- **Record-breaking sales growth** of the trade in addition to the **wages growth and reducing unemployment** was influenced by a number of other factors, including a **growing tendency for consumption**, advised increase in the cost of living in 2008, **households** equipping with **durables** in connection with the innovation cycles of households and the construction of new dwellings, and, last but not least, a **fight for the customer** among the commercial companies.
- Revenues from the **sale of goods and services** reached CZK 3 173.1 billion in current prices, without VAT, and increased year-on-year by 8.9 %. They increased in all areas of trade, most in the **wholesale** by 9.1 %, in the **retail trade** by 8.7 % and in the **motor sport segment** by 8.8 %.
- A **market share** of the large commercial enterprises (with 100 employees or more) in the total receipts from sales has still been **increasing** in all segments of the business. The large enterprises have been reaching the largest share in the retail trade (45.9 %).
- The **concentration of commercial activity** is still ongoing, **large commercial enterprises** (with 100 employees or more) continuously **raise its share in the overall sales**, most in the **retail trade** (45.6 %).
- In the context of large business organizations with 100 or more employees, **companies under foreign control** (sector 11003) continued to develop dynamically. **They have the strongest position in the retail trade**, where they realized more than 81 % of the sales volume in 2007.
- **Revenues from the retail trade (NACE 52) and motor sport segment (NACE 50)** increased year-on-year by **7.7 %** at constant prices, while sales in the **motor sport segment increased by 9.6 %** and **retail sales by 6.8 %**. This is **the highest growth rate** since the beginning of a comparable time series in 1997.
- The year-on-year sales volume in the retail outlets, **dominated by the food range**, increased by 2.8 %, **in non-food stores** by 9.6 %.
- A structure of the **household net cash expenditures** continued to grow in the **spending for housing**, including rent and payments for the supply of energy, water and other services. The **share of expenditure for the purchase of goods** on the internal market has therefore been gradually weakening.
- **The reduction of the number of goods of foreign origin** in the year-on-year total sales by 0.3 p.p. shows that the long-term growth in the volume of imported foreign goods on the consumer market slowed down.

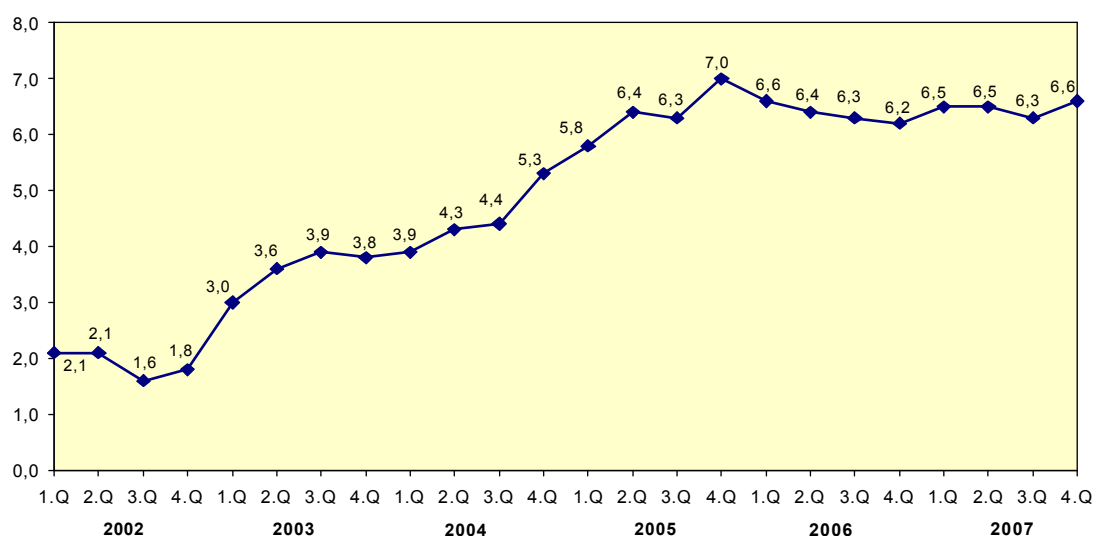
I. MAIN TRENDS OF THE MACROECONOMIC DEVELOPMENT

I.1. Performance of the economy

The year-on-year growth dynamics of the Czech economy in 2007 reached record-breaking levels.

The Czech economy grew by 6.5 % in 2007, which is the best result in its modern history. An acceleration of the economic growth occurred in 2004 (the 5 %-the level was overcome in the 4th quarter), while the growth peak was achieved in the following year (the performance of the economy increased by 7.0 % in the 4th quarter of 2005). In 2006 and 2007 the economy held on a high momentum of the stable pace, which fluctuated around 6.5 %. A growth reached 6.6 % in 4th quarter of the last year, (see the Figure No.I.1.1).

Figure I.1.1 The Gross Domestic Product (the year-on-year % change at constant prices)



Source: Czech Statistical Office, figure: MIT

An increase in the nominal product involved the increase in price levels from one-third.

The Gross Domestic Product at current prices reached CZK 3557.7 billion and was higher by 10.1 % on the year-on year base. In comparison with the previous year (8.2 % growth) a growth of the nominal product accelerated, which was affected by an increase in the aggregate price level by 3.4 %, measured by the implicit GDP deflator (while in 2006 prices rose by only 1.7 %). Improving trade terms by 1.2 p.p. was the main factor of a faster price growth (when export prices of goods and services increased by 0.2 % year-on-year and import ones declined by 1.0 %).

In the context of the domestic demand...

The domestic demand and especially the household consumption was, as well as in 2006, the main source of growth of the Gross Domestic Product in real terms, (see the Table I.1.1). The external sector also contributed to the economic growth, while its contribution in the year-on-year comparison increased slightly. During the year, the stock level again significantly increased (by about 105.4 billion CZK at current prices).

...not only spendings on the final consumption increased...

The household expenditures for the final consumption rose year-on-year by 5.7 % in real terms and slightly overcame the momentum of growth from the previous year (5.4 %). The household demand was particularly encouraged by the developments in the labour market (characterised by the employment growth and

increasing income of households, when the average wage increased by 7.1 %), but also the accessibility of credit products and an attractive offer on the market. **In the course of the year the development of household consumption slowed down** (up to 4 % in the 4th quarter), because the strong tendency for consumption, which was supported by the advised raising costs of living in 2008, weakened mainly as a result of the acceleration of price movements at the end of the year.

The Government expenditure increased year-on-year by 0.9 % (after stagnation in 2006). This result was influenced by the developments in the 4th quarter (up 3.1 %), when, in particular, health insurance costs increased, seemingly in the context of the increased interest of citizens in the health services before the introduction of fees in 2008.

*... but also
formation of the
fixed capital*

Also the **formation of the fixed capital** accelerated growth, when, after the year-on-year increase of 5.5 % in 2006, **rose** by 6.1 %. The fastest growing investments in transport equipment (8.6 %) were followed by the investments to machinery and equipment (7.9 %), housing (7.2 %) and other buildings and structures (4.8 %). The acceleration of investment expenditures in the 4th quarter (by 8.0 %) could be a positive signal in terms of a further development of the economy.

*The positive
development of the
external sector
also contributed to
the economic
growth*

The trend of a faster growth of exports of goods and services at constant prices prior to their imports resumed in the foreign trade for the four years in a row. As regards the amount of this advance, there was no greater change in the comparison with the year 2006 because both exports (up 14.5 %) and imports (up 13.7 %) basically maintained the momentum of the previous year (14.4 %, respectively 13.8 %). This development confirms the good condition of the Czech exports, but also a considerable import intensity of the Czech economy.

The relationship between growth of exports of goods and services (14.7 %) and imports (12.5 %) **at current prices** was more favourable than in real terms, while the **active balance of the foreign trade increased year-on-year by CZK 66.3 billion to CZK 165.9 billion**.

Table I.1.1 The aggregate demand and its components in 2007

	Current prices billion CZK	Year-on-year change in % current prices)		
		2006	2007	4. quarter 2007
Final consumption	2426,5	3,8	4,2	3,7
- households	1689,0	5,4	5,7	4,0
- government	713,0	0,0	0,9	3,1
- non-profit institutions	24,5	11,2	2,5	1,0
Gross capital formation	965,2	11,0	9,2	7,1
- fixed capital	856,7	5,5	6,1	8,0
Export of goods and services	2808,7	14,4	14,5	12,5
Import of goods and services	2642,8	13,8	13,7	10,2
Net exports	165,9	0,9 ^{x)}	1,0 ^{x)}	2,1 ^{x)}
Gross domestic product	3557,7	6,4	6,5	6,6

Source: The Czech Statistical Office, The Table: MIT

Note: Due to the rounding it occurs to inaccuracies in the decimal places of some accumulating data.

^{x)} contribution to the GDP change

*Performance
increased ...*

On the supply side of the economy, the **gross value added in constant prices increased** (by 6.4 % on the year-on-year base). A slower growth when compared with the GDP growth coincided with a lower subsidies for products (5.4 %) than taxes from products (6.9 %). The gross value added in the finance and insurance

companies grew fastest (14.7 %), followed by the trade (12.1 %) and by the manufacturing industry (11.1 %).

... particularly in the manufacturing industry...

The **manufacturing industry** contributed most to the growth of the gross value added (3.0 p.p.), a contribution of the **trade, catering and transport sector** (which in total contributed by 2.5 p.p.) and **finance and services for enterprises** was also significant (1.7 p.p.). On the other hand, the year-on-year decline in the gross value added was in agriculture and energy.

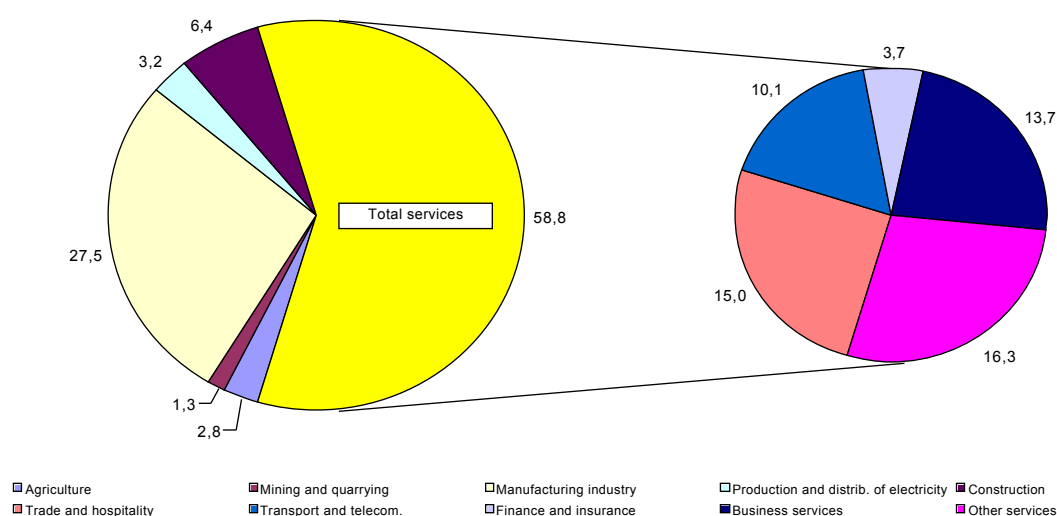
...a share of which in the gross value added further increased...

The **sectoral structure of the gross value added** (at current prices) showed an increased share of the industry up to 32 % (from 31.7 % in 2006), solely due to the **manufacturing industry** (whose share increased year-on-year by 0.8 p.p. to 27.5 %). The gross value added share of **agriculture** increased to 2.8 % (from 2.6 %), while a share of the construction industry stagnated (6.4 %).

... especially at the expense of services

A share of the **total services** in the gross value added decreased to 58.8 % (from 59.3 % in 2006) with the result that a deeper decline in this sector was mitigated by the developments in the **sector of services for businesses** (increase in the proportion from 13.4 % to 13.7 %) and **financial intermediation** (increase from 3.5 % to 3.7 %). The year-on-year decline in the share from 15.2 % to 15.0 % occurred in the trade and hospitality sector (see the Figure No. I.1.2).

Figure I.1.2 The sectoral structure of the GDP
(the proportion in the gross value added, in % from the current prices)



Source: The Czech Statistical Office, Figure: MIT

Labour productivity grew faster than real wages

When employment grew by 1.8 %, the **labour productivity of the national economy increased** (gross domestic product per worker) by 4.6 % (by 4.4 % in 2006). A favourable trend of the faster productivity growth than the pace of change in real wages continued for the fourth year in a row (in 2007 the advance was 0.4 p.p.).

I.2. Structure of the economy

Changes in the structure of economy result the state of the business environment

To complement a view of the situation and developments in the economy, in addition to the analysis of economic results, also a preview of its organisational structure may serve. After the dramatic transformation of the organizational structure of the economy in the nineties, the current state is approaching to the stabilized arrangement with a forecast of only moderate developmentary changes responding to a specific economic situation and conditions for doing business.

An overview of the structures of the national economy in view of the aspects of legal forms, institutional sectors and prevailing activities can be derived from the Business Register (BR), which is managed by the CZSO. It gives evidence on the development of a number of the registered players.

Its explanatory power is influenced by the non-distinction, whether the registered entity developed an activity throughout the whole period or not. The share of actually doing business operators in the long term is estimated at around 55 % of the total number of listed entities. Due to the specific explanatory capabilities of the BR data, in the next parts, the attention is especially paid to long-term trends and developments in the structures as opposed to the absolute quantification.

Table I.2.1 Registered economic entities (number of units as of 31.12.)

	In thousands. 2007	Average pace of growth in %		Year-on-year change in %	
		2000/1995	2005/2000	2006/2005	2007/2006
Units in total	2481,9	9,2	3,1	1,8	2,1
Thereof: private entrepreneurs	1928,5	8,4	2,4	0,9	0,9
Thereof: small traders	1719,5	8,0	2,7	1,0	1,3
legal persons	553,4	13,5	5,9	5,1	6,8
Thereof: trading companies	290,2	12,7	4,7	5,5	7,1
cooperatives	14,9	12,3	4,7	4,0	3,4
state enterprises	0,6	-13,2	-7,8	-10,5	-9,9

Source: CZSO

Growth in the number of operators has significantly slowed down

From the longer-term point of view, the BR predicates on a (Table I.2.1) high growth in the total number of registered players between 1995 and 2000, which significantly slowed down in the following five-year period. Both a number of private entrepreneurs and a number of legal persons underwent this development, in the course of which a number of the state enterprises diminished throughout the whole period reviewed, so that their number is now entirely minority, which corresponds to the course of the restructuring of the economy.

Development of the forms of activities is continual

While an increase in the number of economic entities in the recent years significantly slowed down, **changes in the structure, in terms of legal forms and institutional sectors, are still ongoing (Table I.2.2).** Almost without an interruption, a proportion of the number of legal persons was increasing to the detriment of small traders and independently managing peasants. Forms of business of the people saw a sharp soaring from the zero level immediately after 1990, when the obstacles to their development were removed. In next development, a number of the private entrepreneurs were increasing with a significantly lower rate, due to the competitive and economic pressures.

Table I.2.2 The structure of economic entities by selected legal forms and institutional sectors
(in %)

	1995	2000	2005	2006	2007
A. Breakdown by legal forms					
Private entrepreneurs (natural persons)	85,1	81,9	79,3	78,7	77,7
of which: self-employed (under the Trade Licensing Act)	75,7	71,7	70,4	69,9	69,3
self-managed peasants	7,0	5,0	4,2	4,1	3,9
other*/	2,4	5,2	4,8	4,8	4,5
Legal persons	14,9	18,1	20,7	21,3	22,3
of which: commercial companies	8,5	10,0	10,7	11,1	11,7
cooperatives	0,5	0,5	0,6	0,6	0,6
state-owned enterprises	0,2	0,1	0,03	0,03	0,02
Associations, contributory organizations and other	5,7	7,5	9,3	9,5	10,0
Registered units in total	100,0	100,0	100,0	100,0	100,0
B. Breakdown by institutional sectors					
Public enterprises and corporations	0,3	0,1	0,1	0,1	0,1
Private enterprises and corporations	10,9	13,6	15,0	15,6	16,4
of which: under foreign control	2,0	4,6	5,5	5,8	6,2
Households	84,0	81,2	78,6	78,0	77,0
Other	4,8	5,1	6,3	6,3	6,5

Source: CZSO

*/ The category "Other" of private entrepreneurs includes natural persons other than those doing business under the Trade Licensing Act, in addition to self-managed peasants

In terms of the institutional sectors, since 1995, without an interruption the percentage of households (even if it is still by far the greatest) has been reducing and gradually **increasing the proportion of private enterprises and corporations**, including, in particular, the proportion of **companies under foreign control**, which, since 1995, more than tripled. In particular, these companies are an accelerator of the economic growth and export performance. Their activity is associated with the intensive jobs creation, which significantly influences the situation on the labour market.

In 2007 the economic expansion resulted in the pace of change.

An excellent performance of the economy **in 2007** implicated a development in the economic structures. The year-on-year increase in the number of registered economic entities (2.1 %) **was the highest over the last four years**, the number of registered legal entities increased particularly significant (by 6.8 %), which was also the highest year-on-year increase over the last four years. As in previous years, their increase was significantly higher than for the private entrepreneurs (individuals). The continued **decline in the share of self-orientated farmers** can be put into context with the strong imports of a cheaper agricultural production.

Industry structure adjusted slowly

A basic sectoral structure of the entities, listed under their principal activity, is stabilized in the long-term. The order of the first four most represented sectors did not alter over the reviewing period. It is showed in the Table I.2.3 including the quantification of shares.

Table I.2.3 The structure of economic entities registered under the prevailing activity
(most represented sector, shares in the total number of registered players in %)

Sector (NACE)	1995	2000	2005	2006	2007
G - Trade	31,2	31,1	27,6	27,4	27,3
K - Real estate and rental activities	16,2	16,3	19,2	19,5	20,0
D - Manufacturing industry	14,1	12,8	12,9	12,7	12,5
F - Construction	10,8	10,7	11,3	11,4	11,6
O - Public, social and personal services	6,8	7,7	8,0	8,1	8,3
A - Agriculture, hunting, forestry	8,5	6,4	5,8	5,6	5,6

Source: CZSO

The status of trade is strongly influenced by the nature of this sector, which offers wide possibilities to the independent professionals. A gradual weakening of the share of trade, but also of the manufacturing industry, in the overall number of economic entities is linked up to a progressive centralisation of these activities into the increasingly larger operating units.

A high demand for new operational, marketing and logistics capacities and the realization of huge development projects resulted in the steadily increasing proportion of a number of operators in the **field of real estate and leasing and in the area of construction**.

The intersection effects of a growth in the purchasing power, increasing standard of living, but also the consequences of the ageing population, can be attributed to the continuous raising entities operating **in the fields of public social and personal services**.

I.3. Labour market

Population of the Czech Republic continues to grow

The total population has been continually growing since 2003, and, at the end of 2007 reached 10 381.1 thousands of people, while year-on-year increased by 93.9 thousands. This increase was primarily influenced by the immigration of foreigners (83.9 thousands.), but the population development was characterized by the numerical dominance of live births over deceased for the second year, and the natural increase amounted to 10 thousands of people. The most children for the past 15 years was born in 2007 (114.6 thousands).

A number of the economically inactive persons increased

A number of the economically active people decreased slightly (by 1.1 thousands to 5 198.3 thousands). **A number of economically inactive persons**, on the contrary, increased by 72.8 thousands to 3 646.8 thousands, mainly due to an increase in the number of people in ordinary old age pension. A number of students and women on maternity leave, respectively in the household were also growing. **The level of economic activity** (the share of economically active persons in the number of people aged over 15 years), with the increase in the number of economically inactive persons decreased by 0.5 p.p. to 58.8 % (see the Table I.3.1).

Table I.3.1 Economic activity of the population (in thousands of people)

	Year			Share in %		Change (2007-2006)	
	2005	2006	2007	2006	2007	absol.	v %
Population 15 years or more	8 716,0	8 773,4	8 845,1	100,0	100,0	71,7	0,8
- economically active (labour force)	5 174,2	5 199,4	5 198,3	59,3	58,8	-1,1	0
- employed	4 764,0	4 828,1	4 922,0	55,0	55,6	93,9	1,9
- unemployed	410,2	371,3	276,3	4,2	3,2	-95,0	-25,6
- economically inactive	3 541,8	3 574,0	3 646,8	40,7	41,2	72,8	2,0
- thereof: full old-age pensioners	1 823,5	1 830,2	1 914,9	20,9	21,6	84,7	4,6
disability pensioners	310,3	267,0	246,8	3,0	2,8	-20,2	-7,6
secondary school students and apprentices	511,1	511,1	526,4	6,0	5,9	4,3	0,8
students at the University	256,8	265,5	287,5	3,0	3,2	22,0	8,3
care for the family, household	316,5	319,6	346,5	3,6	3,9	26,9	8,4
other	323,6	369,6	324,7	7,2	3,8	-44,9	-12,2

Source: Czech Statistical Office - LFS

Employment grew significantly in the secondary and tertiary sectors

A number of workers in the national economy, in a single (main) job (see the Table I.3.2), increased year-on-year by 93.9 thousands, i.e. by 1.9 % to 4 922 thousands of people and reached the highest level since 1998. A proportion of women in the overall employment were 43 %. **An employment rate** (the proportion of the number of people with the sole or main occupation in the number of persons over 15 years of age) with an increasing number of workers grew by 0.6 p.p. to 55.6 %. Since ninetieth, the employment has **been declining** in the **primary sector** (agriculture, forestry, fishing), where a total number of workers year-on-year decreased by 5.4 thousands to 176.3 thousands, i.e. by about 0.2 p.p. to 3.6 % of the total employment. In contrast, **in the secondary sector** (industry, construction), **a number of workers increased** by 49.9 thousands to 1 979.3 thousands of people and their share in the total employment grew up by 0.2 p.p. to 40.2 %.

The employment also increased in the tertiary sector (services), year-on-year by 49.4 thousands to 2 766.4 thousands of people under the stagnation of its share to 56.2 %. An employment growth in the various sectors of services was different. Employment increased notably in the sectors of real estate, renting and business services (year-on-year by 31.7 thousands to 353 thousands).

Table I.3.2 Employment in the national economy in a single (main) job (thousands of people)

	Year			Share in %		Change (2007-2006)	
	2005	2006	2007	2006	2007	absol.	v %
Employment in total	4 764,0	4 828,1	4 922,0	100,0	100,0	93,9	1,9
I. sector (agriculture, forestry, fishing)	189,4	181,7	176,3	3,8	3,6	-5,4	-3,0
II. sector (industry and construction)	1 880,5	1 929,4	1 979,3	40,0	40,2	49,9	2,6
III. sector (services in total)* /	2 694,1	2 717,0	2 766,4	56,2	56,2	49,4	1,8

*/ Incl. undetected sectoral pertinence

Source: Czech Statistical Office – Sample survey of labour force

A number of employed foreign workers significantly increased

A number of **foreign nationals employed** in the Czech Republic at the end of the year **significantly increased** by 55.2 thousands year-on-year, i.e. by 29.8 % to 240.2 thousands of people (see the Table I.3.3). A lack of the domestic workers for available jobs in certain professions is the reason. A **number of registered persons**, including foreigners, who do not need permission to work, **increased** by 31.3 thousands to 154.9 thousands in the structure and at the same time, a **number of the work permits granted** to foreigners from the third countries **increased** by 35.5 thousands to 85.4 thousands. Most of employed foreigners came from Slovakia (101.2 thousands), Ukraine (61.6 thousands) and Poland (23.6 thousands).

Table I.3.3 Employment of foreign nationals

	As of 31 st .December			Share in v % 2007	Change (2007-2006)	
	2005	2006	2007		Abs.	in %
Number of records in total	96 519	123 623	154 891	64,5	31 268	25,3
- Citizens of the EU / EEA and Switzerland	93 867	116 846	144 751	60,3	27 905	23,9
- Foreigners without work permits obligations	2 652	6 777	10 140	4,2	3 363	49,6
Number of work permits	55 207	61 452	85 351	35,5	23 899	38,9
Number of foreign nationals Total	151 726	185 075	240 242	100,0	55 167	29,8

Source: Ministry of Labour and Social Affairs

A number of entrepreneurs increased due to a growing number of foreigners

A **total number of entrepreneurs, registered** in the Business Register of the Czech Republic as natural and legal persons, reached 2 054.3 thousands at the end of the year, i.e. by 23.6 thousands of people (1.2 %) more than a year ago (see the Table I.3.4). The Business Register registers entrepreneurs, regardless of whether they perform this activity as the main job or not.

Table I.3.4 Number of entrepreneurs acting on the basis of trade license

	As of 31. December			Change (2007-2006)	
	2005	2006	2007	Abs	In %
Entrepreneurs total	2 005 882	2 030 759	2 054 325	23 566	1,2
of which: individuals	1 751 940	1 773 785	1 787 057	13 272	0,7
legal entities	253 942	256 974	267 268	10 294	4,0
Entrepreneurs- foreigners	67 246	65 722	68 785	3 063	4,7
Share in %	3,35	3,23	3,34	0,11	-

Source: Ministry of Industry, Business Register

A number of **foreigners, working as entrepreneurs on the basis of trade license**, according to the state at the end of the year, increased year-on-year by 3.1 thousands to 68.8 thousands of people. A majority of entrepreneurs-foreigners came from Vietnam (24 437), Ukraine (21 927) and Slovakia (8 684).

A low proportion of the part-time work in the Czech Republic

There is a high differentiation in the **proportion of the part-time workers in the total employment** within the European Union (see the Table I.3.5). In particular, in the original EU-15 countries a high number of women seize an opportunity of working on shortened working hours. As to France, there is a relatively lower proportion of the part time work, which is perhaps influenced by the 35-hours working week. A proportion of the part time work is significantly lower for countries that joined the EU at a later date. The Czech Republic has a share of

part-time workers by 13.1p.p. lesser against the average for the EU-27. The part-time working helps, in particular, women with small children to better reconcile work and family responsibilities and facilitate entry into the labour market and exit from it. An insufficient use of the part time working in the Czech Republic greatly reduces a flexibility of the labour market.

Table I.3.5 The share of part-time workers in the total employment in selected countries in 2007
(listed in descending order in %)

	EU-27	Netherlands	Germany	United Kingdom	Austria	France	Poland	Estonia	ČR	Slovakia
Total	18,0	46,7	25,8	25,2	22,3	16,8	8,9	8,3	4,9	2,5
Men	7,6	23,6	9,4	10,8	7,3	5,5	6,3	4,6	2,3	1,1
Women	30,8	74,8	45,4	41,8	40,6	29,7	12,1	12,1	8,3	4,2

Note: The latest data are for the third quarter 2007

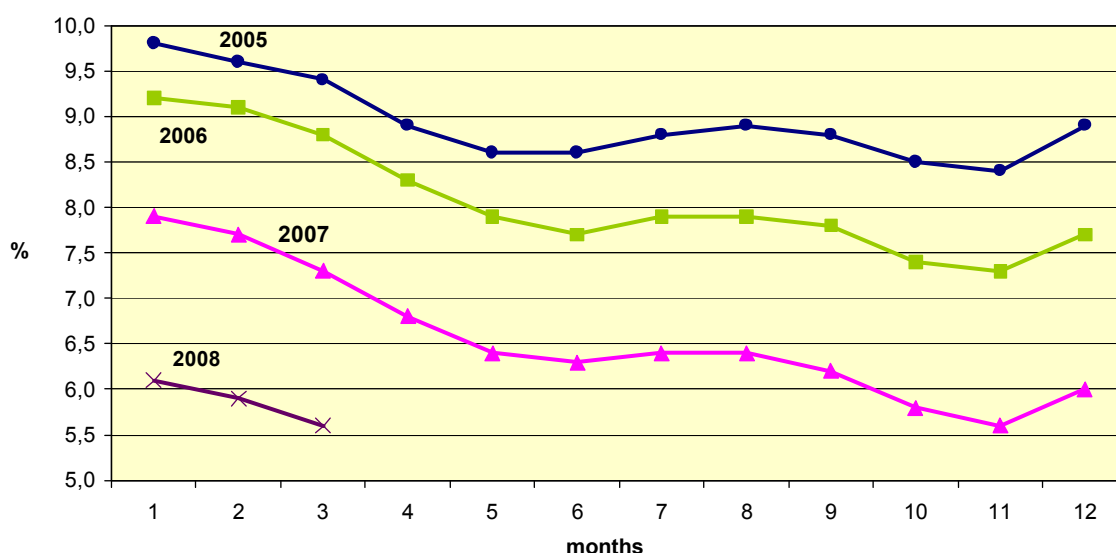
Source: Eurostat

An unemployment rate decreased dramatically...

A registered unemployment rate reported a strong year-on-year decrease for the whole year 2007, and reached 6 % as of December 31, i.e. by about 1.7 p.p. less than a year ago (see the Figure No. 1.3.1). An unemployment rate at the end of the year, due to the seasonality (restraints on the activities of the construction firms) increased from 5.6 % in November to 6 % in December.

The average year-on-year unemployment rate for the year **fell** by 1.5 p.p. to 6.6 % and was the lowest since 1998. Developments in the labour market in 2007 can be assessed as positive. On the other hand, there is still strong discrepancy between the supply and demand in terms of the skill needs.

Figure I.3.1 Registered unemployment rate (%)



Source: MLSA, chart: MIT

A number of job seekers decreased year-on-year by more than a quarter

With a growing economy a number of job seekers **decreased** (year-on-year by 93.7 thousands to 354.9 thousands i.e. by 26.4 % as of 31 December), of which 331,7 thousands of candidates (93.5 %) were available for starting the work immediately at a suitable job offer. A **number** of unemployed women **decreased**

by 47.6 thousands to 191.2 thousands at the end of the year, but their share in the total number rose by 0.7 p.p. to 53.9 %.

A greater proportion of candidates received support of unemployment than a year ago

A number of persons, who received the **support of unemployment** as of 31 December, decreased by 17.2 thousands and reached 112.7 thousands of candidates, namely 31.8 % of all registered persons (prior to 29 %). The average monthly amount of the aid in the 4th quarter amounted to CZK 4 945, i.e. by CZK 327 more than a year ago. In 2007, in total 558.5 thousands of job seekers **newly reported** at the offices of the work, (i.e. year-on-year by of 52.2 thousands less) and 652.2 thousands of persons were **excluded from the evidence**, i.e. by about 20.4 thousands less than a year ago. It **managed to place** 411.7 thousands of candidates out of the total number of eliminated candidates, namely 63.1 % (63.9 % in a prior year).

Rapid increase in the job vacancies

A lack of personnel, particularly in the technical professions began to show in some newly established or expanding businesses. As of December 31, there were **available 141.1 thousands of vacancies**, which was by 47.6 thousands, i.e. by 50.1 % more than a year ago. As of 31 December, 2.5 candidates accounted for 1 vacancy (4.8 in 2006).

At the end of the year, according to the classification of employment (KZAM), the most vacancies were in the Class 7 - skilled craftsmen and manufacturers (45.3 thousands, i.e. 32.1 %), in the Class 8 – operating staff for machines and equipment (28.8 thousands, i.e. 20.4 %) and in the Class 9 - auxiliary and unskilled workers (27.9 thousands i.e. 19,8 %). **According to the education**, there was a greatest demand for the qualified workers and workers with the lower secondary education (57.8 thousands, i.e. 41 % of all vacancies).

A number of unemployed graduates and applicants with disabilities reduced

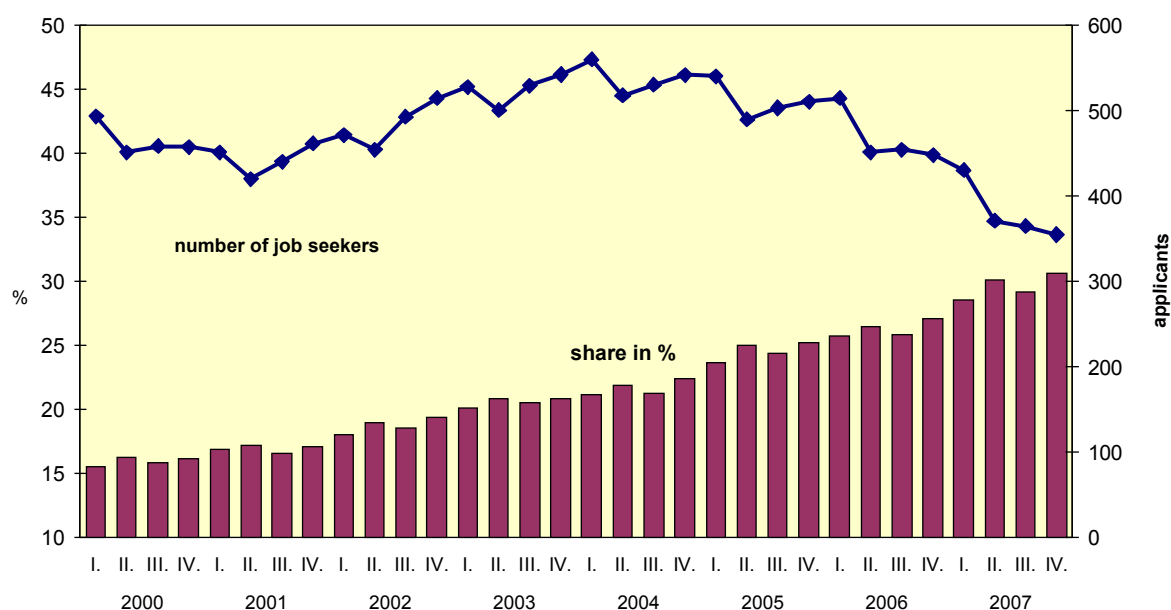
Altogether 22.7 thousands of the unemployed **graduates and underage people** were registered as of 31 December, i.e. by of 9.3 thousands **less** than a year ago, and their share in the total unemployment dropped by 0.7 p.p. to 6.4 %. A demand for graduates with knowledge of the information technology and foreign languages was increasing.

Along with the overall decline of the unemployment rate, a number of candidates with **disabilities** also declined (year-on-year by 6.1 thousands to 65.2 thousands as of 31 December), but their share in the total number of applicants increased by 2,5 p.p. to 18.4 %.

Proportion of applicants over 50 years reached nearly one third of all unemployed

An average age of the job seekers increased year-on-year from 39.2 to 40.4 years as of 31 December. A structure of the applicants broken down **by age** (see the Annex Table I) shows that a **proportion of the applicants over 50 years** rose by 3.5 p.p. to 30.6 %, i.e. to 108.7 thousands, despite the absolute decline in a total number. A proportion of the applicants aged over 50 increased by 15 p.p. compared to the year 2000 (see the Figure No. I.3.2.).

Figure I.3.2 The proportion of applicants aged over 50 in the total number of unemployed
(at the end of the quarter – in %)



Source: MLSA, chart: MIT

Share of the unemployed graduates increased

A structure broken down **by the qualification** showed that the most of registered applicants were persons with the apprenticeship and middle-education, without the GCSE (150.7 thousands, which is 42.5 % of all applicants). Nearly 14 thousands of persons with a higher education were registered. Their share in the number of all candidates increased year-on-year by 0.4 p.p. to 3.9 %.

According to the **length of unemployment**, 136.9 thousands of the **long-term unemployed** applicants (i.e. 38.6 % of the total number of applicants), which was unemployed for more than 1 year, were registered at the end of the year and remained the biggest group of jobless people. Their relative decline by 2.6 p.p. against the previous year can be regarded as a positive development. A **long-term unemployment rate**, i.e. the proportion of the long-term unemployed in the total labour force decreased year-on-year by 0.9 p.p. to 2.5 % at the end of the year according to the calculation of the MIT.

Unemployment rate dropped also in the EU

According to the data of the Statistical Office of Eurostat, the **unemployment rate in the European Union countries (EU-27) decreased** year-on-year by 0.8 p.p. to 6.8 % at the end of the year. The highest unemployment rate was in Slovakia (10.8 %), and on the contrary, the lowest in the Netherlands (2.9 %) and Denmark (3.1 %). According to the Eurostat data and methodology, the Czech unemployment rate reached 4.7 % in the same period, which was by 2.1 p.p. lower than the average achieved in the EU-27. According to the Eurostat's estimates, there were 16.2 million of people unemployed in the European Union at the end of the year. As to the other economically developed countries, a level of unemployment reached 5.0 % in the USA and 3,8 % in Japan.

Growth in nominal wages continued

A declining unemployment and an increased demand for the labour were putting pressure on the wage growth. The development of the nominal wages slowed from 2001 to 2005, but accelerated in 2006 and 2007. The **average monthly nominal wages in companies with 20 employees or more** in the business sphere (in financial intermediation, regardless of the number of employees) and

in all organizations of the non-business sphere increased year-on-year by 7.3 % to CZK 21 692, and **real wages** increased by 4.4 %. The increase in real wages, due to a decline in the consumer price index, peaked in 2003 and, after the following stagnation, increased again in 2006. In the 4th quarter of 2007 itself, the real growth (1.9 %) was, due to an increase in the inflation, the slowest during the last two years.

Wages in the business sector grew faster than in non-business sector

A payroll growth was mainly influenced by the business community, where it began to show a lack of workers in many industries. A nominal wage in the **business sector** amounted to CZK 21 853 (year-on-year increase by 7.5 % and 4.6 % in real terms) and in the **non-business sector** CZK 21 117 (year-on-year increase in nominal wages by 6.7 % and real wages by 3.8 % (see the Table I.3.6). In the year-on-year comparison, the worsening of the relations between an average wage in the non-business sector and in the business sector increased by 0.7 p.p. to 96.6 % in total.

Table I.3.6 The average monthly wage¹ (year-on-year increase in %)

	2005		2006		2007		Average monthly wage In 2007 in CZK
	Nominal	Real	Nominal	Real	Nominal	Real	
Total:	5,3	3,3	6,4	3,8	7,3	4,4	21 692
Out of which:							
-Business sphere	5,1	3,1	6,7	4,1	7,5	4,6	21 853
-Non-business sphere	5,7	3,7	5,4	2,8	6,7	3,8	21 117

Source: The CZSO

The highest salaries were in financial intermediation, in the multinational companies in Prague

The highest wages in the **sectoral breakdown** (under the NACE Sections) were achieved in the financial intermediation (41 541 CZK) and lowest in the accommodation and catering (15 529 CZK – see the Table I. 3.7). The cross-sectoral wage differentiation, in terms of the share of standard deflection from the average wage, according to the calculation of MIT, decreased year-on-year by 1.1 p.p. to 28.4 %. In a **more detailed sectoral breakdown** (by NACE sections), the highest wages were paid to employees in the air transport (56 739 CZK) and the lowest wages were in the production of clothing and fur manufacturing and dyeing (11 593 CZK, which is 53.4 % of the average wage). The year-on-year difference between these sectors increased by CZK 5 501 to CZK 45 146.

According to the type of management, the highest wages were paid by the multinational companies (26 044 CZK) and the lowest ones by cooperatives (14 529 CZK). The year-on-year difference increased by CZK 194 to 11 515 CZK.

¹ in the economic entities of the business sphere with 20 employees or more (in the financial intermediation irrespective of the number of employees) and in all organisations of non-business sphere

Table I.3.7 Order under the above-average nominal wages¹
(according to NACE categories - in CZK)

Order In 2007		Cat. NACE	2006	2007	Change (2007 – 2006)	
					In CZK	In %
1	Financial intermediation	J	39 706	41 541	1 835	4,6
2	Electricity, gas and water supply	E	26 331	28 156	1 825	6,9
3	Mining and quarrying	C	24 190	25 917	1 727	7,1
4	Public administration and defence, social security	L	22 896	24 636	1 740	7,6
5	Real estate activities and rental, business activities	K	22 473	24 013	1 540	6,9
6	Transport, storage and communication	I	21 811	23 174	1 363	6,2
7	Construction	F	20 258	21 956	1 698	8,4
8	Sales and repairs of motor vehicles	G	20 037	21 875	1 838	9,2
9	Manufacturing industry	D	19 012	20 424	1 412	7,4
10	Health and social care, veterinary activities	N	19 021	19 916	895	4,7
11	Education	M	18 358	19 429	1 071	5,8
12	Other public, social and personal services	O	16 569	17 867	1 298	7,8
13	Fishing, fish breeding	B	16 836	17 370	534	3,2
14	Agriculture and hunting, forestry	A	14 843	16 357	1 514	10,2
15	Accommodation and catering	H	14 051	15 529	1 478	10,5
CR in total			20 207	21 692	1 485	7,3

Source: CZSO

***Wage intensity of
the GDP was
declining***

The average nominal wage throughout the economy, including the estimates for small businesses, increased by 7.1 % year-on-year to CZK 20 333 and **real wages** increased by 4.2 %. The relationship of the nominal wages volume, in relation to the GDP at current prices (**wage intensity of the GDP**), reached 28.4 % when decreased by 0.3 p.p. year-on-year.

A **differentiation** of the share of employees' compensation to the GDP at current prices within the European Union **can be calculated from the Eurostat data**.

Table I.3.8 A differentiation of the share of employees' compensation to the GDP at current prices within the EU can be calculated from the Eurostat data

Listed in descending order as per 2007

	2005	2006	2007 (1.-3.Q)
Denmark	52,7	52,6	53,9
France	52,2	51,9	51,9
Belgium	50,1	49,8	50,2
Germany	50,5	49,5	48,7
Finland	49,2	48,6	48,2
Austria	48,8	48,5	48,0
Estonia	43,7	44,5	47,5
Lithuania	41,9	43,1	47,2
Spain	47,0	46,5	46,6
Luxembourg	46,8	45,1	45,3
Cyprus	44,9	44,8	44,3
Latvia	41,2	42,7	43,4
Malta	44,8	43,9	42,8
Czech Republic	42,9	42,8	41,9
Ireland	41,2	41,8	41,5
Italy	40,8	41,2	40,7
Slovakia	37,2	36,8	36,0
EU- 27	49,1	48,7	48,2
Eurozone (13 countries)	48,1	47,6	47,3

* EU-27: only data for listed countries are available

Note: Compensation of employees consist of wages, salaries and employers' social security

Source: Eurostat

The compensations of employees to the GDP (see Table I.3.8) are higher in the economically more advanced states of the European Union. The figures, obtained in the Czech Republic, are against the average for the EU-27 lower by about 6 p.p. The Czech Republic is one of the bottom half of the EU countries in this indicator. A share of the compensations to the GDP was declining in the most of the EU countries, suggesting low-wage development, which was necessary to uphold a competitiveness of the economies.

I.4. Price and fiscal policy

I.4.1. Price policy

In recent months, the prices significantly speed up the growth rate

A relatively low and stable inflation from the previous years held the line only at the beginning of 2007. In the coming months, on the contrary, the consumer prices started to rise **more progressively than in the past years** (in September by 2.8 % year-on-year). Their acceleration (in November to 5.0 % in December to 5.4 %) to the highest growth since August 2001 **turned up with that the impact of administrative measures was joined by the increase in prices of food and energy**. The strong Czech crown performed anti-inflationary (cheapening imported goods), particularly when hindered the growth in fuel prices.

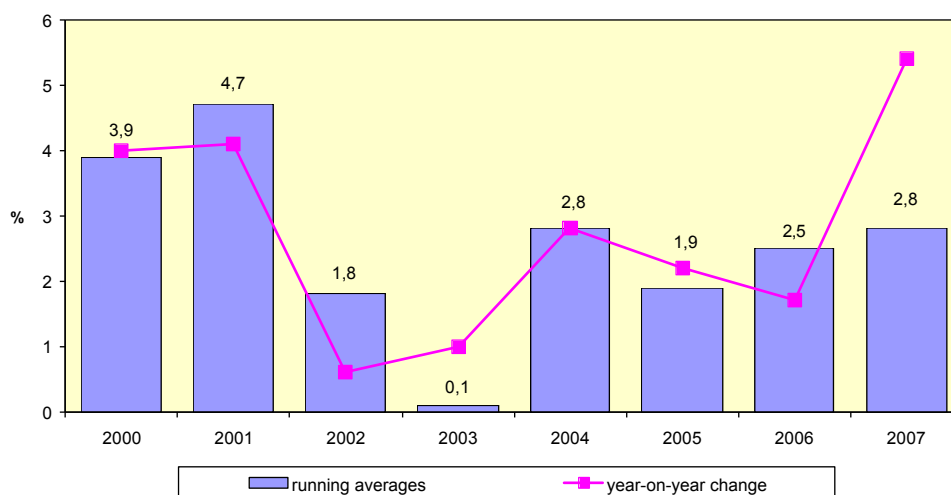
The inflation rate changed the trend since October

Following this trend, the average inflation rate (running average for 12 months) fell since January, in August and September stagnated at 2.0 % and **changed the trend since October, when it began to grow up to 2.8 % in December** (by 0.3 p.p. higher value than in 2006).

The analysis of the year-on-year increase in consumer prices in 2007 shows that the **increase in the price levels** by an average of 2.8 % **comprised of:**

- equal share (0.8 p.p.) of price increase in the sections of food and soft drinks, alcoholic beverages and tobacco and housing;
- price increase (0.2 p.p.) in the section of food and accommodation;
- price increase in the sections of health and other goods and services (by 0.1 p.p.).

Figure. I.4.1.1 Development of consumer prices since 2000 (in %)



Source: The Czech Statistical Office, chart MIT

During the 4th quarter a growth in regulated prices accelerated to 13.0 % (from 10.2 % in the 3rd quarter), in market prices to 3.2 % (from 1.0 % in the 3rd quarter). The following administrative objective measures effected in 2007:

- **in January** prices increased by 3.8 % in total, rose by 7.9 % mainly in the section of housing, water, energy and electricity, by 4.5 % in the net rent, by 6.6 % for water rate, by 5.5 % for water release. As a result of the delayed impact of the increase in excise duty (since April 2006), prices of the tobacco products increased by 2.5 %. Due to changes in the law on the provision of social services, the prices of social care increased by 2.8 %, television concessionary fee increased vigorously by 20.0 %. The fall in prices of the natural gas by 4.2 % took effect in the opposite way,
- **in February**, again due to the delayed impact of the increase in excise duty, the prices of tobacco products rose by 3.3 %, costs of heating and hot water (consistently by 1.0 %), the prices of social care increased by 12.0 % due to an amendment in the law on provision of social services,
- **in March**, a further increase in the price of tobacco products by 3.3 % affected the price level,
- **in April**, prices of the tobacco products were rising for the fourth month in a row, also the gas price increased by 1.4 %, heat by 0.6 %, the net rent by 0.9 %,
- **in May**, the prices of tobacco products increased by 2.6 %, net rent in the section of housing increased of 2.0 %, in the health section, the prices for spa stays were higher by 10.7 %,
- **in June** the prices of tobacco products continued to increase (by 2.1 %), net rents, in the section housing, increased by 0.5 %,
- **in July**, net rent of flats with regulated rent, in the section housing, rose by 1.9 %, gas prices by 1.6 %, increase in the prices of tobacco products reached 2.0 %. In the section of health, supplements for the medicines,

- *prescribed by the doctor, reduced by 2.0 % and prices of spa stays by 1.1 %,*
- **in August**, the prices of tobacco products increased by further 6.2 %, net rental housing in flats with regulated rent by 1, 2 %,
- **in September**, the prices for telephone and telefax services dropped by 0.6 % due to a cheaper roaming set in the section of post and telecommunications. In particular, the supplements for medication prescribed by the doctor, decreased by 1.7 % in the health section. In addition, net rental increased in flats with the regulated rent by 1.3 % and gas price by 0.2 %. The increase in prices of tobacco products slowed to 0.6 %,
- **in October**, growth of housing prices was affected by further increase in the price of natural gas by 4.7 % and of the heat by 0.6 %,
- **in November**, the prices of tobacco products increased by the additional 0.6 %.

Home HICP remained below the EU average only in the 1st quarter

Due to a rising inflation **since April 2007, the domestic prices remained above the level of EU countries and their progressive growth dynamics at the end of the year ranked the Czech Republic among the fastest growing inflation rate countries** (according to the harmonised index of consumer prices, by its growth in the amount of 5.5 % they were by 2.3 p.p. above than the average for the EU 27, in the average per year with the level of 3.0 % - by 0.6 p.p. above). In 2008 the prices raised most in Latvia (14.0 %) and Bulgaria (11.6 %), the lowest growth value was showed in the Netherlands (1.6 %) and Finland (1.9 %). A table set out in the Annex Table provides a comparison of price developments in the selected countries.

Industrial producers prices continued in strong growth...

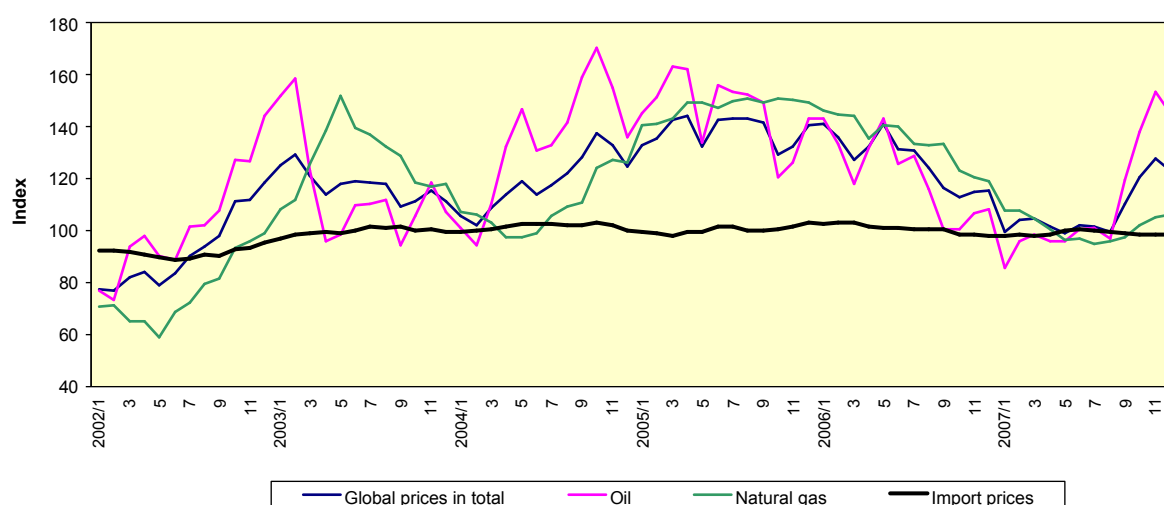
Throughout the year of 2007 the industrial producer prices increased substantially (from 2.6 % at the end of 2006 to 5.2 % in December and to 6.0 % in January 2008), with a moderate slowing pace in August, mainly due to the temporary drop in oil prices in connection with the mortgage crisis on the U.S. market (see the Table in the Annex Table).

The year-on-year growth in the industrial producer prices (the average for the year 2007 was 4.1 % compared to 1.6 % in 2006) was the highest for the last three years and was primarily driven by the price increases in the following sectors:

- coal, lignite, peat, oil (in average by 8.8 %) with mostly two-digits growth in the 2nd half of the year,
- energy, gas and water (in average by 7.4 %) and especially electricity and its distribution (by 9.2 %),
- basic metals, metallurgical and metal products (in average by 6.7 %), mainly from the iron, Steel and ferro-alloys (by 9.2 %), cast iron and steel pipes (by 13.3 %).

... prices grew faster than in the EU

A comparison of the prices of industrial producers in the Czech Republic and the EU shows that there is a clear differentiation in price developments. **While prices in the EU slowed the growth significantly since the beginning of the year** (from 3.4 % at the end of 2006 to 1.6 % in August), and then began to rise (up to 4.6 % in December), **industrial producers' prices in the domestic market were increasing progressively since the beginning of the year** (from 2.6 % at the end of 2006 to 5.2 % in December 2007) and slowed down temporarily in the 3rd quarter. A comparison of price developments in the Czech Republic and the EU gives a Table in the Table Annex.

Figure I.4.1.2 Development of import prices on the global markets (year-on-year index %)

Source: Czech Statistical Office, chart MIT

Which resulted in the development of import prices

In the course of 2007 the import prices held (with the exception of June and July) below the level of the previous year (in December by 1.3 %) and afforded opportunities for the weakening of external cost pressures on the growth of the domestic prices. The structure of import prices was developing conversely, which was affected by a change in the trend of two groups of imports; namely energy (see Figure No. I.4.1.2) and other raw materials. The continued strengthening of the Czech crown to the Euro and the dollar contributed to the acceleration of the decline in import prices of industrial consumer goods (in December by 5.0 %) and the prices of imported machinery and equipment (a decrease of 4.7 %); non-energy prices, even after significant slowdown in growth of world metals prices were still rising (in December by 6.1 %). The prices of mineral fuels, however, showed the opposite trend. As a result of the renewed growth in the world prices for energy, the fall in prices of the mineral fuels in September was followed by a moderate year-on-year growth (by 0.9 %), which strengthened in December (17.6 %). The year-on-year growth in food prices after the 1.5 % decline at the beginning of the year, gradually accelerated and reached 4.9 % in December.

Table I.4.1.1 Development of prices in the main price areas (year-on-year in %)

	2000		2001		2002		2003		2004		2005		2006		2007	
	Dec.	average	Dec.	average	Dec.	average	Dec.	average	Dec.	average	Dec.	average	Dec.	average	Dec.	average
prices																
-consumers	4,0	3,9	4,1	4,7	0,6	1,8	1,0	0,1	2,8	2,8	2,2	1,9	1,7	2,5	5,4	2,8
- industrial producers	5,0	4,9	0,8	2,9	-0,7	-0,5	0,9	-0,3	7,7	5,7	-0,3	3,0	2,6	1,6	5,3	4,1
- building works	4,7	4,0	3,4	4,1	2,1	2,7	2,3	2,2	4,3	3,7	2,5	3,0	3,2	2,9	4,4	3,9
- agricultural produce	9,0	9,2	1,8	8,4	-15,6	-9,5	8,0	-2,9	2,4	8,1	-5,2	-9,2	4,9	2,2	26,6	16,5
- market services	4,9	3,4	1,7	3,9	3,9	3,2	0,4	1,6	2,8	2,3	1,6	1,9	3,9	3,7	1,6	1,6
- import	6,8	12,0	-7,0	-1,5	-4,4	-8,5	-0,3	-0,3	0,1	1,6	2,9	0,3	-2,0	0,8	-1,3	-1,0

Source: The CZSO

Prices of the construction work still achieve a high growth rate

The prices of construction work further accelerated its **progressive rate of growth** during 2007, in connection with an ongoing high demand for the construction of flats, family houses and buildings in the area of infrastructure and a continuous growth of the sector lasting for several years, (from 3,2 % in December 2006 to 4.4 % in December 2007 and 4.6 % in January 2008).

The agricultural producers prices grew predominantly in a double-digit pace

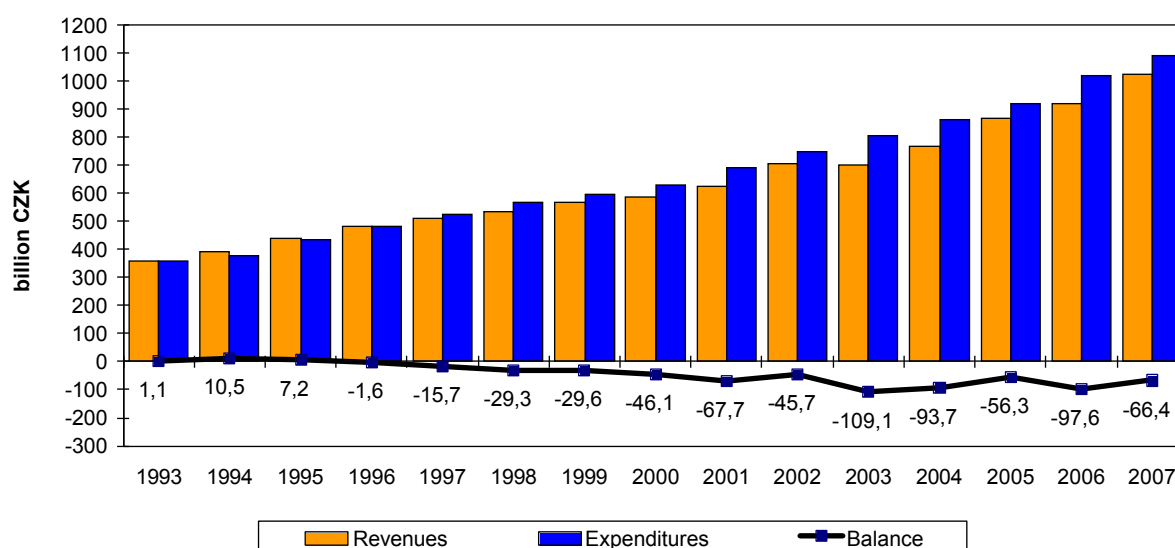
The agricultural producers' prices have been increasing since the end of 2006. Although their growth for the whole year of 2007 was largely double digit, they gained even greater pace in the second half of the year and reached 26.6 % in December and 26.9 % then in January 2008, (compared with 8.1 % at the end of 2006). A strong growth in prices of vegetable products, launched in mid-2006, continued (the year-on-year by 37.6 % in December, in January 2008 by 36.9 %), particularly in a consequence of the higher prices for cereals by 67.0 % and fruit by 50.3 %, prices of oil also increased by 33.9 % and, on the contrary, prices of potatoes were lower by 34.1 % and vegetables by 1.3 % (due to the high base in the previous year). In August, the prices of animal products, which held below the previous year for two years, joined this trend while increased by 14.9 % in December 2007 of which the price for milk rose by 28.0 %, eggs by 25.4 % and poultry by 23 %. A long-term increase in the world demand for food, due to a rapid economic growth in Asia, particularly in China, plant production outages caused by the lower crop, not only in the EU countries, but also in the U.S.A. and Ukraine, and the cost factor of growth in fuel prices can be found behind this development.

I.4.2. Fiscal policy

The deficit of the state budget was approved in the amount of 91.3 billion CZK

The state budget for 2007 was approved with a deficit of CZK 91.3 billion, with the revenues amounting to CZK 949.48 billion and expenditures of CZK 1040.78 billion, which, compared to the approved budget for 2006, indicated a growth in the deficit of 16.9 billion CZK. There were fairly significant changes of the approved budget during the year, while revenues increased by 16.49 billion and the expenditures by CZK 17.07 billion CZK. Accordingly, the state budget deficit rose by 0.58 billion CZK. The development of the state budget in time series since 1993 is shown in the chart No. I.4.2.1.

Figure I.4.2.1 Development of the state budget since 1993 (in billion CZK)



Source: Ministry of Finance, chart MIT

The final state budget deficit accounted for 1.9 % of the Individual Income Tax (IIT).

A fluctuating management of the Treasury, that moved predominantly in the negative values for the first months of the year, stopped in June, and its accumulated balance showed a net positive outcome for the six months in a row. In the last quarter a faster drawdown of the expenditures was apparent with the result that the December deficit of 79.16 billion CZK was caused, as well as in the past years, due to a higher capital expenditures spending and transfers of the unused funds into the reserves of the OSS. **The state budget deficit in 2007 amounting to 66.39 billion CZK was by 24.9 billion CZK (about 27.3 %) lower than a foreseen budget approved by the law for the year 2007 and by 31.2 billion CZK better than in 2006.** It represented 1.9 % of the GDP (against 3.1 % in 2006), which is a significant improvement in the management of public finances.

Table I.4.2.1 Treasury budget performance in 2007
(in billion CZK, the accumulation since the beginning of the year)

Month	Revenues	Expenditures	Balance Accumulated	Balance Per month
January	83,14	78,11	5,03	5,03
February	147,57	154,30	-6,73	-11,76
March	241,98	230,72	11,26	17,99
April	318,22	335,23	-17,01	-28,27
May	378,15	404,13	-25,98	-8,97
June	483,32	482,04	1,28	27,26
July	581,18	561,50	19,68	18,40
August	656,66	634,44	22,22	2,54
September	748,52	712,21	36,31	14,09
October	835,37	808,17	27,20	-9,11
November	908,23	895,46	12,77	-14,43
December	1025,88	1092,27	-66,39	-79,16

Source: Ministry of Finance

The highest income momentum showed the growth of the IIT

Mainly the tax revenues in total took a share in the growth **on the revenue side of the state budget** (year-on-year growth by 11.1 %), which, with the volume of 900.65 billion CZK, increased by 97.76 billion CZK, i.e. by 12.2 % on the year-on-year base. Results of the state budget for the year 2007 are documented in the Table I.4.2.2.

A pace of spending growth was lower than that of the revenues

Out of the total expenditures (1092.27 billion CZK with the year-on-year growth of CZK 71.63 billion, i.e. 7.0 %) in particular, **current expenditures were spent** in 2007, (976, 75 billion, i.e. 6.7 % growth). The less significant capital expenditures in the volume (115.53 billion CZK), however, reached again a high momentum of growth (9.7 %). The total expenditures of the state budget in 2007 accounted for 30.7 % of the GDP (in 2006 it was 31.6 %).

Table I.4.2.2 Structure of the state budget performance in 2007 (in billion CZK)

	2006 Reality January- December	2007		% Delivering	Index 2007/2006
		Budget After alteration x)	Reality January- December		
Total revenues	923,06	965,97	1025,88	106,2	111,1
Tax revenues	802,89	871,85	900,65	103,3	112,2
thereof:					
Personal income tax	91,59	98,10	102,14	104,1	111,5
Corporate income tax	95,47	107,50	114,75	106,7	120,2
VAT	153,52	163,60	166,63	101,9	108,5
Excise duty	112,56	131,30	131,59	100,2	116,9
Premiums for soc. security					
Contribution to employment policy	333,70	354,95	367,14	103,4	110,0
Other	16,05	16,40	18,40	112,2	114,6
Non-fiscal and other income	120,17	94,12	125,23	133,1	104,2
Total expenditures	1 020,64	1 057,85	1 092,27	103,3	107,0
Including					
Current expenditure	915,34	955,11	976,75	102,3	106,7
of which: social benefits	354,44	387,61	386,38	99,7	109,0
of which pensions	272,91	289,71	289,86	100,1	106,2
Capital expenditures	105,30	102,74	115,53	112,4	109,7
Net balance- total	-97,58	-91,88	-66,39	x	x

Source: Ministry of Finance

note.: x) State budget adjusted as of December 31. 2007

The gross national debt further deepened

In 2007 the long-term trend of increasing national debt continued (which began in 1997, after a decline in the years 1993 - 1996), when it rose to 892.3 billion CZK (year-on-year by CZK 89.9 billion, i.e. 11.2 %). The increase was mainly due to the developments in the budget management and due to the realization of the payment of a part of the loss of the Czech Consolidation Agency in the amount of 13.2 billion CZK. The balance of the internal public debt increased by 88.5 billion CZK and external debt rose by 1.4 billion CZK. The State borrowings in the volume of 273.5 billion CZK consisted mainly of the government bonds emissions. In total, the 23 short-term emissions of the government bonds (treasury bills) were made. Funding for the sale of TB emissions in the amount of 115.8 billion CZK and for the medium-and long-term emissions of the government bonds amounting to 151.2 billion CZK (furthermore, loans from the EIB amounted to CZK 4.8 billion and 2.7 billion made short-term loans in the domestic market) served to payments for the long-term government debt and to cover the deficits of the state budget.

The regional budgets ended with a surplus

The management of the regional budgets ended with surplus of 9.4 billion CZK for the year 2007 (when the budget envisaged a deficit of CZK 6.7 billion), thanks to lower costs. The municipalities and the Voluntary Ties of Municipalities generated a crucial part of the surplus, when their revenues exceeded expenditures by 8.3 billion CZK, in regions by 1.1 billion CZK. Total revenues of the local government units (counties, municipalities, voluntary ties and regional councils of regional cohesion) amounted to 371.5 billion CZK (performance of 97.7 %), expenditures were spent in the amount of 362.1 billion CZK (performance: 94.1 % of the budget).

Deficit in public budgets reduced significantly,...

The year-on-year management of public budgets (including net borrowing) improved significantly when closed with the deficit of 35.9 billion CZK, which was by 87.6 billion CZK lower than envisaged by the law approved budgetary documentation for 2007. It reached about a quarter deficit declared for the year 2006 (142.1 billion CZK), which was historically the highest deficit. It

represented merely 1 % of the GDP (against 4.4 % in 2006). Results of all entities of the public budgets improved with the exception of extra-budgetary funds. A positive development in this index is an important indicator of the slowdown in the fiscal expansion.

... when both revenues and expenditure remained unsaturated

The total revenues in the amount of 1375.7 billion CZK remained unsaturated (about CZK 7.9 billion), although it increased by 11 %, because of a lower drawdown of the subsidies from the supranational institutions (the EU funds to co-finance programmes) and revenues from privatisation (the anticipated sale of the ČEZ shares was not realized). At the same time, expenditures in the volume of 1 411.6 billion CZK were lower than the prediction by 95.4 billion CZK, so that their year-on-year growth slowed to 2.2 %. The subsidies to financial institutions fell significantly (by 52.7 %, due to a decline in spending on the transformation costs), by contrast, there was an increase in the payment of losses of the Czech Consolidation Agency.

The amount of the public budget deficit affected the development of the indebtedness of public budgets, which reached 973.2 billion CZK at the end of 2007 (the year-on-year increase by CZK 95.5 billion, i.e. 10.9 %) and **represented 27.4 % of the GDP**. It was generated, in particular, by the growth of the public debt of the CCA losses.

I.5. Monetary policy and foreign direct investments

I.5.1. Monetary policy

The Czech National Bank responded by several tightening of monetary policy to the fears of potential growth in inflation

In the environment of a strong economic growth with a high consumption of households, which was joined by the factor of a progressive growth in the consumer prices in the second half of 2007 and for fears of potential inflationary pressures, the Czech National Bank responded by gradually increasing the basic interest rate (1 June, 27 July, 31 August and 30 November - always by $\frac{1}{4}$ p.p.). **The fourth adaptation put the two-weekly repo rate to 3.5 %, discount rate to 2.5 % and the Lombard rate to 4.5 %** and, in consequence of that, the reference interest rate increased to the highest value over the past five and a half years. From the international perspective, however, the basic domestic interest rates remained very low, as shown in the Table I.5.1.1.

Table I.5.1.1 Comparison of interest rates in the Czech Republic, the ECB and selected national banks of the EU and USA

	Basic rate in %									
	12/2004	12/2005	3/2006	06/2006	9/2006	12/2006	3/2007	6/2007	9/2007	12/2007
Czech Republic	2,50	2,00	2,00	2,00	2,50	2,50	2,50	2,75	3,25	3,50
Eurozone	2,00	2,25	2,50	2,75	3,00	3,50	3,75	4,00	4,00	4,00
Sweden	2,00	1,50	1,75	2,00	2,50	3,00	3,25	3,25	3,75	4,00
United Kingdom	4,75	4,50	4,50	4,50	4,75	5,00	5,25	5,50	5,75	5,50
Hungary	10,00	6,00	6,00	6,00	7,25	8,00	8,00	8,00	7,50	7,50
Poland	6,50	4,50	4,00	4,00	4,00	4,00	4,00	4,25	4,75	5,00
Slovakia	4,00	3,00	3,50	4,00	4,50	4,75	4,75	4,25	4,25	4,25
USA	2,00	4,00	4,50	5,00	5,25	5,25	5,25	5,25	4,75	4,25

Source: The CNB

Movement of the client interest rates were differentiated

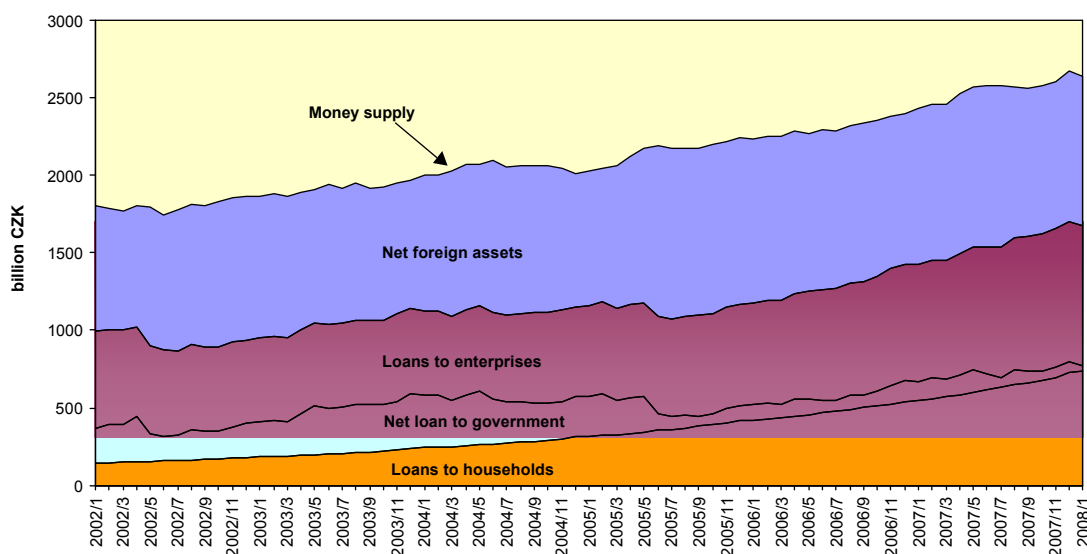
An effect of the increasing basic rates of the CNB on the development of the client interest rates was differentiated, so that the rate of total loans to households decreased slightly from May and stagnated at 6.6 % while it rose to non-financial corporations, on the contrary, since the end of the first half of the year up to 5.5 % as of December. The interest rate for new businesses began to grow both for the households and non-financial corporations (in December to 11.8 %, i.e. by 5.3 %). The rates on deposits started to increase slightly at the end of the second quarter, first for businesses (in December to 1.7 %, respectively 1.8 %), followed up by households at the end of the 4th quarter (to 1.4 % and 1.2 % in December).

The real interest rate (in relation to consumer prices) decreased significantly, during the acceleration in inflation in the 4th quarter, to favour loans, the interest rate of which dropped in real terms in December for households up to 1.2 %, from new business to 6.4 %, for non-financial companies to 0.1 %. On the other hand, the depreciation of deposits significantly increased (in December for households to 4 % in real terms, for new businesses to 4.2 %, for non-financial corporations to 3.7 %, respectively. 3.6 %).

The dynamics of a growth of money supply increased...

Right at the beginning of 2007, the money supply (M2 aggregate) returned (after almost five years) to the **double-digit year-on-year growth, which peaked in December** (by 13.2 % or 2 478.3 billion CZK while it rose by 9.9 % in December 2006). The domestic capital has been a main source of the money supply growth since more than one and half year, particularly the growth of the domestic credit to businesses and households, while a net credit to the government stood below the previous year level since July. The **foreign capital** mainly decreased since June 2006 on the year-on-year base (in December by 0.4 % in December 2006 by 9.6 %), so its **share of the influx of money into the economy was gradually reducing** up to 39.1 % in December (against 57.7 % In July 2005, when the inflow peaked). The developments of the main sources of money supply are shown in the Chart No I.5.1.1.

Figure I.5.1.1 The main sources of the monetary supply growth
(since 2002, in billion CZK, at the end of the period)



Source: CNB, chart MIT

... supported by credit growth to business sector...

The raising interest rates (also due to the growth of inflation) have not yet resulted in the demand for loans. It remained high, both in the corporate sector and in households, being supported by the continued strong growth in the economy. The pace of growth of loans to businesses, which since two and a half years have been achieving the double-digit levels, further intensively grew (in December by 21.1 % to 902.4 billion CZK, while it rose by 14.7 % in December 2006). The short-term loans were the fastest-growing ones in the loans structure, which was linked to the need for companies to finance the trading capital, while the pace of loans with the longer due dates were delaying in connection with a moderate slow down of the investment activities of the enterprises.

.... and for population

The year-on-year pace of growth of loans to households, which at the turn of 2006 and 2007 fell temporarily under the level of 30 %, **gradually accelerated** during the year to, as yet, the utmost value of the year-on-year gain in the history of the Czech Republic (from 29.4 % in December 2006 to 34.3 % in December 2007, i.e. to CZK 726.3 billion). It was supported by an increasing disposable income of the households and by a high consumer demand, the development of the real estate market, the expected increase in the VAT rates for the construction work related to housing, the continuing deregulation of rents, still favourable levels of the interest rates and by the offer of banks. Both loans for housing and consumer credit loans took a part in this development. A household loans share in the clients' credits also increased up to 44.6 % in December (while it was only 13 % for the starting year 1993).

The Czech crown was affected mainly by the venture capital

The increasing basic domestic interest rates and good results of the domestic economy were a determining factor for the development of the exchange rate of the Czech crown in 2007. The **Czech crown followed especially the developments of the Euro-dollar market**, the movement of currencies in the Central European region and the global flow of the venture capital.

The Czech crown continued to adhere to the long-term trend of appreciation against the two main currencies

Over the course of the year a movement of the Czech crown was not always clear-cut but it still **continued in the long-term trend of the evaluation against the reference currencies**, which peaked in December, reaching new maximum both to the dollar and Euro. The development of the exchange rate of the Czech crown to both currencies, including the figuration of its long-term trend in the balancing, which is sheerer for the dollar, is depicted in the Chart No. I.5.1.2. The Czech crown was by 26 % stronger against the default rate of the Euro in force since January 1999 in December 2007 and against the dollar evaluated by 41 % over the same period (against the default rate of 1990, i.e. 28 CZK / USD, appreciated by almost 36 %).

Figure I.5.1.2 Development of the nominal exchange rate of CZK to USD and EUR to USD (January 2, 2002 – February 29 2, 2007)



Source: CNB, chart MIT

At the end of the year the Czech crown evaluated to the new maximum...

In the first half of the year, the Czech crown was led to a weaker exchange rate against the EURO by the investors dealings, who borrowed the low-interest-bearing Czech crown and converted it, by return, to other, better rate-bearing currencies. No sooner that during the summer months a contra flexure came into being owing to the turbulence on the global financial markets brought up by the crisis of the U.S. low-grade mortgages. This led investors to enter into the speculative positions funded by the low-interest-bearing Czech crown and generated an increased demand for the Czech crown, which began significantly strengthen in consequence of it.

... rate of exchange to the Euro...

At the end of October, affected by a favourable sentiment in the region, the **Czech crown to EURO got under the level of 27 CZK / EUR for the first time in history**. In the coming weeks it continued in shifting to its utmost limit. **Over the course of 2007** and in the context of these developments, the exchange rate of the Czech crown against the Euro was as follows:

- it reached the **utmost** value of 26,000 CZK / EURO on 10 December;
- its **bottom** value was 28,775 CZK / EUR on 3 July;
- evaluated by 2 % **in the average for the year** (for 2006 by 4.8 % for 2005 by 6.6 %);
- evaluated by 5.3 % **against the December of the previous year** (in December 2006 by 4.1 % in December 2005 by 5.5 %).

... as well as to the dollar

The rate of exchange of the Czech Crown to US Dollar was under the influence of the weakening dollar / Euro rate on the world markets in the first half of the year and, at the same time, a weaker Czech crown to the Euro. **A turning point came into being in the second half of the year**, soon afterwards the effects of a further decline in the U.S. currency against the Euro and the strengthening exchange rate of the Czech crown to the Euro put together. So the Czech crown overcame its historical maximum to the dollar for several times (the first in January and April, then, starting in July until the end of the year). In the second

half of the year the Czech crown accomplished to overcome records for several days in a row in November and **its rate fell below 18 CZK / USD for the first time in history**. In 2007 the Czech crown against the U.S. dollar:

- **took the historical record-breaking rate** of 17662 CZK / USD on 10 December;
- **the lowest rate** was 21.836 CZK / USD on 29 January;
- **the average rate** of the Czech crown for the year 2007 evaluated by 10.2 % on the year-on-year base (for 2006 by 5.6 %, for 2005 by 6.8 %);
- **against the December of the previous year** evaluated by 14.2 % (in December 2006 by 14 % in December 2005 by 6.9 %).

The Czech crown evaluated in the real terms to both reference currencies

In 2007 the exchange rate of the Czech crown in real terms was, in addition to the development of the nominal exchange rate, affected by the inflation differential margin between the domestic price level and that in the Eurozone, respectively in the United States. Since the domestic consumer prices increased gradually, in particular, over the level of the Eurozone and later also in the United States, **together with the strengthening of the nominal exchange rate of the Czech crown, the accumulation of both effects resulted in the strong real appreciation**. Under these conditions crown evaluated to the Euro by 8.1 % in December, in the real terms and on the year-on-year base (at the end of 2006 by 3.9 % and at the end of 2005 by 5.4 %), to the dollar by high 18.1 % (at the end of 2006 by 15.1 %, while at the end of 2005, on the contrary, weakened by 7.8 %). This was acting adversely on the position of exporters on foreign markets, while also pushing for the decline in import prices, but it had the opposite effect on the financial situation of importers and hindered the domestic inflation. The long-term development of the exchange rate of the Czech crown to both reference currencies is figured out in the Table I.5.1.2.

Table I.5.1.2 The development of the nominal and real exchange rate of the Czech crown

Year	Nominal rate (in CZK)			Real rate					
	Average per year			December 1989 = 100			December of previous year = 100		
	DEM	EUR	USD	DEM	USD	EUR*)	DEM	USD	EUR
1999	18,85	36,88	34,60	127,90	115,04	99,58	98,89	84,24	99,58
2000	18,21	35,61	38,59	134,70	105,94	104,61	105,25	92,10	105,05
2001	17,42	34,08	38,04	147,40	116,00	113,85	109,34	109,20	108,83
2002	.	30,81	32,74	.	135,61	116,44	.	116,36	102,27
2003	.	31,84	28,23	.	156,74	111,28	.	115,41	95,57
2004	.	31,90	25,70	.	179,61	117,53	.	114,28	105,62
2005	.	29,78	23,95	.	166,12	123,90	.	92,19	105,41
2006	.	28,34	22,61	.	196,60	128,70	.	115,07	103,88
2007	.	27,76	20,31	.	241,76	139,12	.	118,10	108,10

Source CNB, the Czech Statistical Office, Eurostat, the BLS U.S. calculations: MIT

*) December 1998 = 100

**Balance of
payments ended
with surplus ...**

The aggregate result of balance of payments² for the year 2007 was positive (15.7 billion CZK, i.e. 0.9 billion USD) and was achieved mostly in the 4th quarter when, after a non-significant positive balance in the first and in the third quarter, foreign transactions in the second quarter required the involvement of the foreign exchange reserves. Despite its balance surplus was not too high, it significantly improved against the previous year. Under the stagnation of the influx of resources on the financial account (104.5 billion CZK, i.e. \$ 5.4 billion and 2.9 % of GDP) this result was **generated by the deficit decline on the current-account** (to CZK 89 billion, i.e. 4.5 billion U.S. dollars and 2.5 % of GDP) and both by the growth of the active balance in the volume-related still less significant **capital account** (to 19.7 billion, i.e. USD 1 billion) and by the **negative balance of foreign exchange rate differences**, errors and omissions (19, 5 billion CZK, i.e. USD 1 billion). The Table I.5.1.3 shows the comparison of the development of the two major accounts of the balance of payment since 2000.

Table I.5.1.3 Development of major accounts of the balance of payments (in billion CZK)

	Year								Year-on-year Change in %
	2000	2001	2002	2003	2004	2005	2006	2007	
Current Account	-104,9	-124,5	-136,4	-160,6	-147,5	-48,5	-100,8	-89,0	-11,8
Trade Balance	-120,8	-116,7	-71,3	-69,8	-13,4	59,4	65,1	117,5	80,4
Balance of services	54,6	58,0	21,9	13,2	16,6	36,5	42,2	55,4	31,4
Income balance	-53,0	-83,5	-115,6	-119,9	-156,6	-155,7	-201,3	-253,8	26,0
Current transfers	14,4	17,8	28,7	15,8	6,0	11,3	-6,8	-8,1	19,2
% GDP	-4,8	-5,3	-5,5	-6,2	-5,2	-1,6	-3,1	-2,5	-0,6 p. b.
Financial Account	148,0	172,8	347,8	157,1	177,3	154,8	104,9	104,5	-0,4
Direct investments	190,8	208,3	270,9	53,5	101,8	279,6	102,8	158,2	53,9
Portfolio investments	-68,2	34,9	-46,7	-35,7	53,0	-81,2	-26,9	-53,2	98,0
Other investments	26,9	-67,1	127,9	135,5	25,7	-40,8	35,3	-2,3	x
% GDP	6,8	7,3	14,1	6,1	6,3	5,2	3,2	2,9	-0,3 p. b.

p. b. = percentual point

Source: CNB, CZSO

**...under the
decline in the
current-account
deficit ...**

The current account deficit decreased significantly on the year-on-year base (by 11.9 billion CZK), while a continuing strong growth of the performance-related balance (by more than 60 % i.e. by 65.6 billion CZK to 172 billion CZK) was enough of almost 70 % to compensate a progressively increasing deficit in the balance of output (in the current deterioration of the negative balance of current transfers account). **Changes in its structure**, as manifested since 2002, **further deepened when:**

² Since the 1st quarter of 2007 the revised figures on the balance of payment are published retroactively, in view of the Czech Republic's accession to the EU in 2004. The reason for this revision is the transition to new sources of data on exports and imports of transport and other services. Until recently, they were obtained from the banks on the basis of coding clients bank transactions, using payment titles (with a limit of 12 500 EURO), and consequently, a number of transactions were not included for being under the limit. The new results are replaced with direct CZSO survey respondents in the import and export services. At the same time as data on import of goods, in addition to the detailed disclosure in the CIF methodology (the value of the goods, including foreign trade costs at the border of the importing country), which is valid for the external trade statistics, newly also for the balance of payments statistics published summarily in the methodology of FOB (the value of the goods on the threshold of the exporting country). Data in the structure, and consequently on the outcome of the trade balance are therefore different in the both statistics.

- **the trade balance proved a growth tendency of the surplus** (year-on-year by CZK 52.4 billion in the FOB² prices), to the highest value since 1993, when exports grew faster (15.3 %) than imports (by 13.2 %). The year-on-year trade balance was higher in all quarters, when it was from nearly 40 % afforded in the first quarter. The Chapter IV deals with the Analysis of the trade balance in the CIF2 methodology more in detail;
- **the positive net balance of services continued to increase** (year-on-year by CZK 13.2 billion), thanks to a faster dynamics of the revenues (10.2 %) than the expenditures (by 6.9 %). After several years of the decline, the positive balance for transport services highly increased (year-on-year by 41.2 % i.e. 8.4 billion CZK), as a result of higher revenues from air, rail and road freight transport in particular. On the other hand, a positive net balance of tourism turned the trend (year-on-year declined by 2.8 %, i.e. by CZK 1.8 billion) when its results reflected a growing demand of the Czech citizens for travelling abroad (an increase of expenditures to 18.1 %) under the slower growth of income from foreign tourism (by 7.7 %). A decrease in the deficit of other services also contributed significantly to the improvement of the balance of services (by 16.5 % on the year-on-year base, i.e. by 6.6 billion CZK), where revenues increased (year-on-year by 2.8 %), while expenditures decreased (by 2.6 %);
- **The impetus to deepening the deficit balance of income remained high** (year-on-year by more than a quarter to CZK 52.4 billion). The year-on-year increase in the deficit in the current account showed a neutral result, because it was covered by the same amount of increase in the surplus of the balance of trade. The income balance represents since 2002 the greatest burden of the current account when the year-on-year pace of costs growth was almost double than earnings growth in 2007. Mainly the investment income (by 79.5 % in the amount of CZK 201.6 billion), and, to a lesser extent, compensation of employees (52.2 billion CZK) were involved in the overall deficit. A passive balance of the investment income was generated by the passive balance of the foreign investments (233.3 billion CZK) while net balance from the other, i.e. interest investments (22.5 billion CZK) and portfolio investment (9.2 billion CZK) was positive. The reflux of investment income (319.5 billion Czech crowns) was dominated by the expenditures of direct investments (247.6 billion CZK, i.e. almost 63 %), consisting of both the repatriation of dividends and, in particular, by the volume of reinvested earnings in the amount of 130.6 billion CZK which came back to the domestic economy.

The balance of net reinvested earnings, which simultaneously goes into the two major accounts, and in the consequence of that, their flows are neutral for the result of balance of payments, reached 120.2 billion CZK. In the case of exclusion of re-investments from the balance of the income, the current account would have ended with a surplus of 31.2 billion CZK, i.e. 0.9 % of GDP;

- **a negative balance of the current transfers** increased (by CZK 1.3 billion) as a result of the deficit in financial transfers from households, expenditures on remittances and other financial transfers abroad, including the transactions between the Czech Republic and the budget of the European Union..

*Stagnating influx
of resources on
financial
account...*

The influx of resources on the financial account decreased slightly in 2007 (year-on-year by CZK 0.5 billion) and depended totally on inflows of direct investments, when outflow of the portfolio investments increased, accompanied by outflow of other investments, where the redirection of resources accrued over the course of the year. Likewise in the previous two years, the 1st quarter showed

a net outflow of the financial resources from abroad, which was eliminated immediately in the following period. **The financial account was the result of:**

- **growth influx of the direct investment by more than a half** (to 55.4 billion CZK), even in the absence of significant privatization of the state shareholdings. It was influenced by a strong increase in the FDI inflows in the Czech Republic (year-on-year by 36.3 % i.e. by 49.3 billion CZK), the source of which were particularly reinvested earnings (130.6 billion CZK) and, up to a lesser extent, investments in the increase of the basic capital (57.5 billion CZK). Other funds, by contrast, showed the net outflows (2.8 billion CZK), where repayments of loans of the domestic subsidiaries to the parent companies exceeded over payments of the previous loans by foreign parent companies to the domestic subsidiaries. The direct investments were also affected by the reducing inflow of the domestic direct investments abroad (year-on-year by 18.3 % to 27.1 billion CZK), which were made mostly in the form of other capital (11 billion CZK), i.e. loans to the foreign subsidiaries. The reinvested earnings amounted to 10.5 billion CZK and investment in the basic capital 5.6 billion CZK;
- **the deepening liability in the balance of the portfolio investment** was year-on-year almost doubled (i.e. by 26.3 billion CZK). Its development was influenced both by the purchases of foreign long-term bonds and shares by the domestic non-banking entities on foreign markets and by the banks and also by the interest of foreign investors in the domestic bonds and the Czech crown bonds. The outcome of passive operations also resulted the disposal of domestic shares by non-residents and the bonds issuance on the foreign capital markets (out of which two were the Czech export banks);
- **a capital outflow in the form of other investments**, while inflows in the 3rd quarter was not enough to eliminate the outflows in the remaining three quarters. This development was determined by the changing position of the banking sector (outflow of 16.7 billion against the influx of CZK 25 billion in 2006), which was influenced by the movement of assets of the commercial banks abroad, by the increase of the short-term deposits and loans granted abroad. A highest volume in the net inflows was shown by the corporate sector (12.2 billion CZK against the outflow of the CZK 4.5 billion in 2006). It was the result of the growth of receivables from the export, transactions in import loans and the drawdown of financial and commercial loans from abroad. The net inflows of the government sector reduced year-on-year (by 84.9 % by CZK 12.6 billion to CZK 2.2 billion). Its active operations included an increase in the deposit of the Czech Republic in the international institutions and, by contrast, liabilities were increased by the EIB loans to building the transport and water infrastructure and by the borrowings at the regional level.

The active capital account balance grew progressively (by 132.1 % of to CZK 11.2 billion) when the highest volume surplus for 4th quarter was crucial for it. The advance payments from the budget of the European Union, a positive balance of other transfers (including transfers of property made by migrants, trading in licensing and patent rights and the surplus in the emissions trading contributed to this outcome.

... and contribute to the foreign exchange reserves

The foreign exchange reserves of the Central Bank mainly decreased over the course of the year 2007 to 631 billion CZK as of 31 December 2007 (decreased by 25.6 billion CZK against the end of 2006). In dollar terms, due to the exchange rate movements, they increased, on the contrary, to 34.9 billion USD (i.e. by 3.4 billion USD). It covered the 2.9 monthly imports of goods and services and thus

remained just below the three-month coverage, which is considered safe. In addition to the outcome of balance of payments for the year 2007 (15.7 billion CZK) and the exchange differences, it was affected by the income from their investments, a part of which was realized in clearance sale and for the balance of transactions carried out for clients of the CNB. In the following period, foreign exchange reserves further fell, when amounted to 615.5 billion CZK at the end of February.

Growth of foreign debt continued

The gross foreign debt proved the long-term growth trend and increased to 1 348.8 billion CZK, i.e. 74.6 billion USD as of 31 December 2007, whereas the limit of the billion boundary was exceeded in December 2004 for the first time. It increased by 155.1 billion CZK (13 %) against the end of 2006 in connection with the growth of the liabilities in the banking sector in particular. A level of the foreign debt represented 37.9 % of the GDP (it was 36.9 % at the end of 2006) and thus remained under the generally accepted "safe" limit of 40 %. **A gain in the foreign debt was concentrated in the short-term liabilities** (by CZK 100.5 billion, by 31.3 %, to CZK 422.1 billion, i.e. 23.3 billion USD), so their share in total debt increased to 31.3 % (against 26.9 % at the end of 2006). Although the timing structure evolved in favour of the short-term liabilities, **a decisive volume of foreign debt continued to account for the long-term liabilities** (926.8 billion CZK, i.e. 51.3 billion USD). Despite of their increase by 54.6 billion CZK (by 6.3 %), they reduced its share in the total debt to 68.7 % (from 73.1 % at the end of 2006).

I.5.2. Foreign direct investments and its support

FDI correspond with a greater involvement in the global economy

The foreign direct investment played a significant role in forming a standard market economy and, to a large extent, backed up the good condition of the Czech economy in the course of the changing structure of the industry and development of services and increasingly growing competitiveness of the production for the domestic and foreign markets.

After a slight influx of the FDI at the beginning of the transformation, the inflow of investments significantly strengthened since 1998 and related primarily to the privatisation sale of the state shares of the large Czech banks into the hands of strong foreign strategic partners. At the same time, a robust inflow of investments in the manufacturing industry arose - especially for the sale of the state shares of large companies. High volumes of investments showed the trade sector, where assets of the international trade supply chains were concentrated.

The FDI inflows into the manufacturing industry were, due to the small internal market, especially export-oriented; the aim of the FDI in services was to establish oneself on the domestic market.

Lately the entry of foreign investors directed significantly to the sector of sophisticated services with a high value added, which are associated with the innovation, high-tech production and highly specialized services for businesses (IT services, software development, call-centres, shared centre for the accounting and financial operations, etc.), with the demanding requirements for flexibility of the labour force. By the influence of the cooperative ties between the foreign and domestic enterprises, it occurs, on the one hand, to the convergence of performance and improving the competitiveness of the domestic firms (taking over the advanced processes and technologies, increasing labour productivity, etc.) but, on the other hand, the foreign firms make a hard-competitive environment in some localities and sectors.

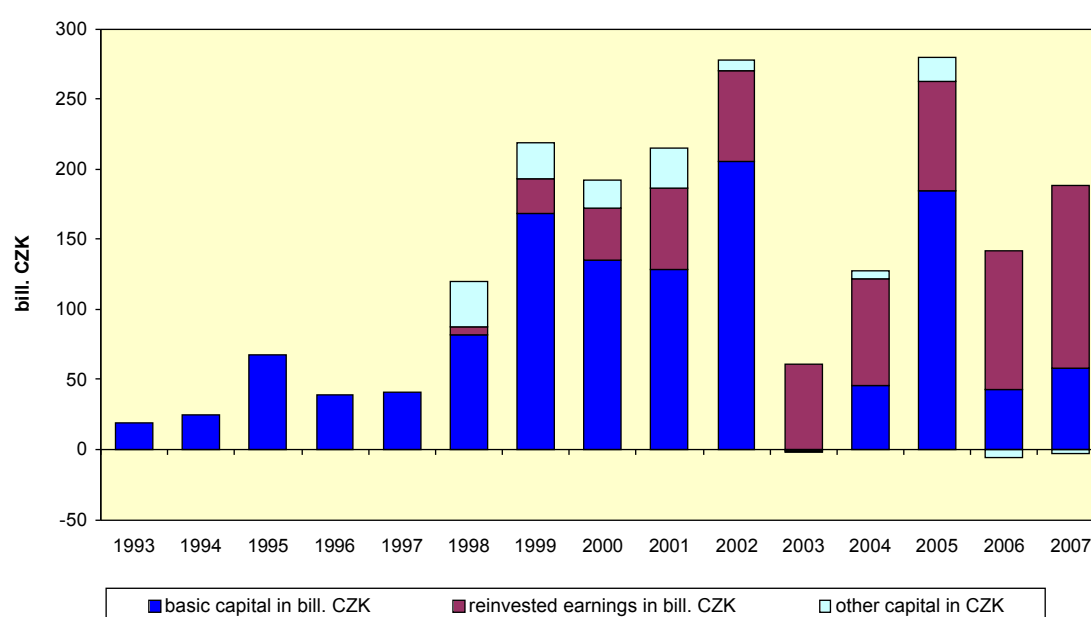
The largest volume of the FDI came from the EU countries

The influx of foreign direct investment in the Czech Republic in 2007 reached 185.3 billion CZK (9.3 billion USD) and was **by 36.4 % higher than in the previous year**. By the structure, 57.5 billion CZK (2.8 billion USD) directed to increasing the share capital of subsidiary companies, the volume of reinvested earnings amounted to 130.6 billion CZK (6.4 billion USD), investment in the form of other capital fell (by 2.8 billion CZK) - see Figure No. 1.5.2.1.

The reinvested earnings occupied the largest share in the FDI

Among the sources of financing from the **foreign direct investments** the **reinvested earnings** - with the long-term growth trend – and **with the highest value since 1993** (see the Chart I.5.2.1) played a leading role. This demonstrates not only the growing profitability of the invested sectors, but it also indicates the positive expectations of the investors in the long-term stability of the domestic economy.

Figure I.5.2.1 Structure of FDI in Czech Republic in the years 1993-2007 (in billion CZK)



Source: the CNB, chart: MIT

Note Until 1997 figures include only foreign direct investment into the basic capital

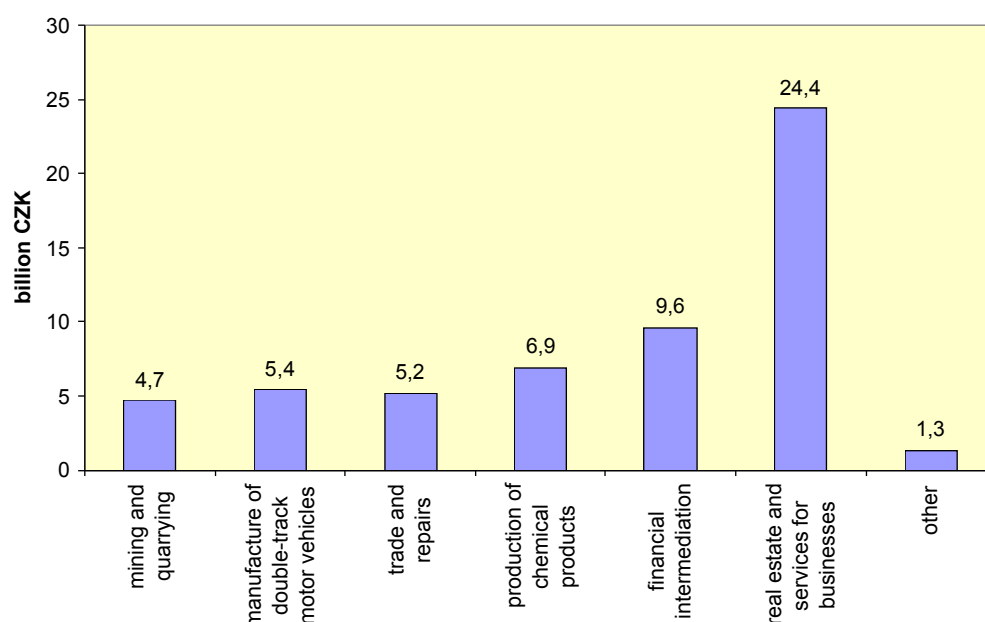
Investments from the EU countries strongly dominated and came mainly from the Netherlands (53.4 billion CZK), Luxembourg (23.8 billion CZK), Austria (21.7 billion CZK), France (19.9 billion CZK) and Germany (15.4 billion CZK). The highest inflow of the capital from **outside Europe was from the Republic of Korea** (7.9 billion CZK) - in connection with the construction of the Hyundai car factory in the Northern Moravian Nošovice, **United States** (7.0 billion CZK) - in the form of reinvested earnings and other capital and **Japan** (5.0 billion CZK).

FDI directed mainly to the real estate and services for businesses and in the financial intermediation

As to the branches of activity, an increase of the basic capital, held by foreign owners, was made **especially in the sector of the purchase of real estates** (major development projects) and the **provision of services for businesses**. It was also going in the financial intermediation and production of chemical products and two-track motor vehicles (see the Figure No. I.5.2.2).

The reinvested earnings were invested particularly in the financial intermediation (28.5 billion CZK), in the production of the two-track motor vehicles (19.3 billion CZK) and trade and repairs (14.9 billion CZK).

Figure I.5.2.2 Influx of FDI under the sectoral structure of the share capital in 2007
(in billion CZK))



Pramen: CNB, figure: MIT

Domestic companies also invested mainly in the EU countries

The FDI outflow from the Czech Republic in 2007 amounted to 27.1 billion CZK (1.4 billion USD), in the same period of 2006, the FDI outflows amounted to 33.2 billion CZK. By its structure, investments in the basic capital made 5.6 billion CZK, reinvested earnings 10.5 billion CZK and other capital 11.0 billion CZK.

The domestic owners put reinvested earnings, in particular, into the **real estates and services for enterprises** and in **trade and repairs**. Loans were granted to the foreign subsidiaries, in particular in the energy sectors, in relation to the activities of the company ČEZ, in a lesser extent, it directed also to the real estate and services for businesses.

Capital investments in the basic capital were made by the companies in the sector of production of electricity, gas and water (3.6 billion CZK) and transport and telecommunications (2.0 billion CZK). A slight increase was shown also in the production of the two-track motor vehicles. The overall reduction in capital investments in the basic capital was influenced by the decline in the financial intermediation.

The Czech companies raised the capital especially in subsidiaries in Georgia and Slovakia. The reinvested earnings were invested in the subsidiaries in Slovakia and Germany and other capital directed to the subsidiaries in Poland, the Netherlands and Georgia.

The MIT decided on Investment Incentives

In the context of changing the EU rules on the granting of aid as of January 1, 2007, when its amount decreased from 50 to 40 %, the investors tried to take the utmost use of these subsidies in 2006. While in **2006 the MIT decided on Investment Incentives for 149 domestic and foreign companies** in the range of investments amounting to 108 billion CZK, the investment incentives **in 2007** were granted only to 55 companies. An extent of their investments amounted to 30.9 billion CZK and the expected number of jobs, produced on that account, was 7 342

In terms of the amount of investment, the domestic investment projects such as the **JUTA, a.s.** (Manufacture of synthetic grass, technical fabrics and non-woven textiles from the natural fibres) - 2.6 billion CZK, **BIOLÍH Kolín, a.s.** (bioethanol production) – investment for more than 2 billion CZK was important. It is supposed that the most jobs would be afforded by the company **Wistron InfoComm (Czech) s.r.o.** (Production of computing technology, PC storage, PC servers, VoIP phones and digital consumer products, LCD televisions) - 603 jobs and by the company **Europahaus-Holzindustries s.r.o.** (Manufacture of prefabricated houses, glued timber profiles and thermic roof elements) - 530 jobs.

In March 2007 the government approved a new framework programme for the promotion of technology centres and centres of strategic services. There was a change in the conditions for obtaining support for the project in the amount of minimum investment and job creation.

Furthermore, in this context, in 2007 it was decided on the support of **57 projects of the technological centres** with a total investment of 6.3 billion CZK and **4 131 new jobs** and **56 projects of the strategic services centres** with investments in the amount of 13.6 billion CZK and **16 147 new jobs**.

As to the projects aimed at the technology centres in terms of investment and job creation, there is a very important project of the Škoda Auto, focused on research, development and testing of the passenger cars. According to the estimated amount of the investment a Hi-tech project of the **LONZA BIOTEC s.r.o.** is a major project in the area of the technology companies (412.7 million Czech crowns). The **Honeywell. s.r.o.** is, in addition, an important investor in terms of the number of jobs afforded. Through the implementation of the innovation of security equipment and facilities for the operation management altogether 432 new jobs should rise.

As regards the projects aimed at the centre of strategic services, a very important project is the one of the company **Exxon Mobile & Chemical**, particularly in terms of new jobs creation (1 300). **The CCG a.s. company** plans one of the highest investment (more than CZK 1 billion). The company plans to build a high - tech repair centre in the Moravia-Silesian region.

All these projects were considered according to the Framework Programme for the promotion of technology centres and strategic services centres, which was in force until the end of 2006.

I.6. Capital market

Unstable global markets...

The developments in the global stock markets in 2007 were accompanied by the increased uncertainty, with the subsequent sensitive reactions to any negative news. **Significant corrections**, which began on the Asian markets, particularly in China and the **crisis in the U.S. market of the risk mortgages** (which affected mainly the financial sector), increased the aversion to risk in the world and transferred gradually to the markets of Central Europe. Although the U.S. in particular, but also partly the European economy has proved to be a slowdown, the world's stock exchanges were still strong and repeated rises and declines in prices of shares did not make a pessimistic mood and fears of a possible negative turnover.

In January 2008, however, a foreseen turnover occurred in the context of the U.S. mortgage crisis and fears of the risk of global economic recession causing a decline of shares in all markets.

... participated in the price volatility of shares in major markets...

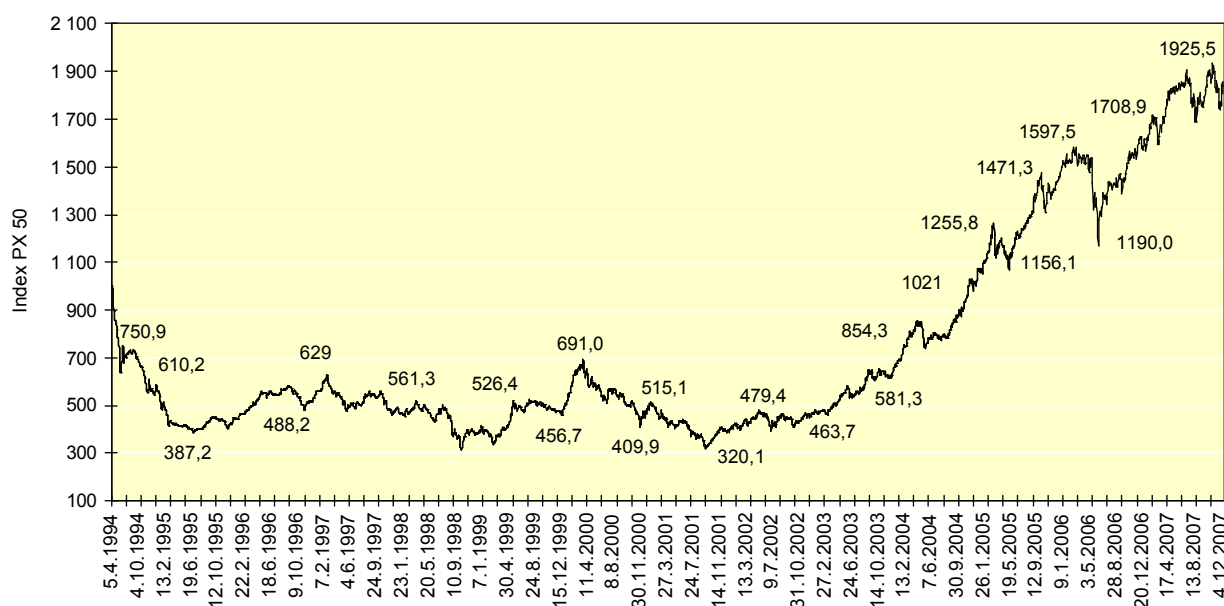
Even though the share rates in global markets were significantly volatile during 2007, good economic performance of U.S.A. and the European economies drove the shares up for the time being. The technological Nasdaq Composite Index rose by 18.7 % on the year-on-year base (*in January 2008, however, decreased by 12.6 % - month-on-month*), stock index S & P 500 strengthened by 3.5 % year-on-year (*in January showed a decrease of 7.8 %*). **As to the major European stock markets, the German DAX, grew by 22.3 % by the most surprise** (in January, however, as the others, fell by 15.1 %), when the German companies after the restructuring in previous years prospered in the export expansion in Asia and Eastern Europe, as well as in the other acquisition campaign, including North America. The London FTSE rose by 3.8 % (in January decreased by 8.9 %) and the Paris CAC 40 strengthened by 1.3 % (*in January depreciated by 13.3 %*).

... also in our region

Markets in Central Europe and their indices under the influence of a favourable economic growth and interest of foreign investors **led also positive**, even though they also did not avoid sinks and corrections. The Hungarian BUX Index and the stock market saw the year-on-year growth by 5.6 % (in January 2008 decreased by 10.5 %). The Index of the Warsaw Stock Exchange WIG 20, which is characterized by a broad retail investor's base (constitutes 40 % of the turnover of the stock market) and offers a significantly higher number of emissions of trading titles, increased year-on-year by 10.4 % (in January, on the contrary, showed a decrease of 14.2 %). This Stock Exchange also allowed the Czech investors to better diversify the portfolio into the companies that did not trade on the Prague Stock Exchange. The Slovak SAX Index increased year-on-year by 7.2 %.

Index of the domestic market further strengthened

The year 2007 was also full of extremes on the Prague Stock Exchange (while in 2006 only shares of the three elite companies of the eleven forfeited, in 2007 the ratio was close to the balance), **like other Central European stock exchanges followed the developments in major markets, its index PX grew and showed the extraordinary results** (see the following chart). The December closed on the value of 1 815.1 points, which is the year-on-year increase by 14.2 % (for January, however, depreciated by 17.4 %), with the year-on-year minimum of 1 565.3 and a maximum of 1 936.1 points. The largest increase in 2007 showed shares of CEZ and Unipetrol (more than 40 %), which benefited from the positive sentiment towards the energy sector, namely thanks to the record-breaking oil prices and electricity, and next the CME. On the other hand, shares of the Philip Morris and Zentiva lost (more than 20 %), which suffered from the poor economic performance; the Orco as a developer was negatively affected by the sentiment towards its sector, which has changed significantly from the positive in the first quarter to a significantly negative during the second half of the year.

Figure I.6.1 INDEX PX 50, PX (April 5, 1994 - December 28, 2007)

Source: PSE, chart MIT

At the end of January 2007 the Ministry of Industry and Trade gave the new entity - Energy Prague stock exchange based by the Prague Stock Exchange - a licence allowing it to organise the electricity market. This new commodity exchange declared its intention to achieve a greater transparency in the domestic pricing of the electricity market.

The main market leader is the Prague Stock Exchange

The most of the total volume of transactions (1 532.6 billion), made in the domestic capital market in 2007, was intermediated again by the Prague Stock Exchange, that traded 99.3 % of transactions amounting to 1 521.9 billion CZK, which, however, represented the year-on-year decline in the market share of 0.3 p.p.. The RM-System accounted for 7.7 billion CZK and the rest for the Prague Securities Centre. Summary of business development at the Prague Stock Exchange shows the Table I.6.1.

Trading in the RM-S and Prague Securities Centre increased significantly

RM-System with transactions of shares and participation certificates for the total 7.7 billion CZK **significantly increased the volume of transactions** (to 0.5 % of the entire market), when year-on-year increased by 96.5 %. The RM Index in June surpassed the limit of 3 000 points and, in December, ended in the value of 3 385.30 (year-on-year increased by 29.8 %). Transactions, attributable to the **Prague Securities Centre**, reached 3.0 billion CZK (year-on-year increased by 15.8 %) out of which the shares and participation certificates ensured 2.1 billion CZK.

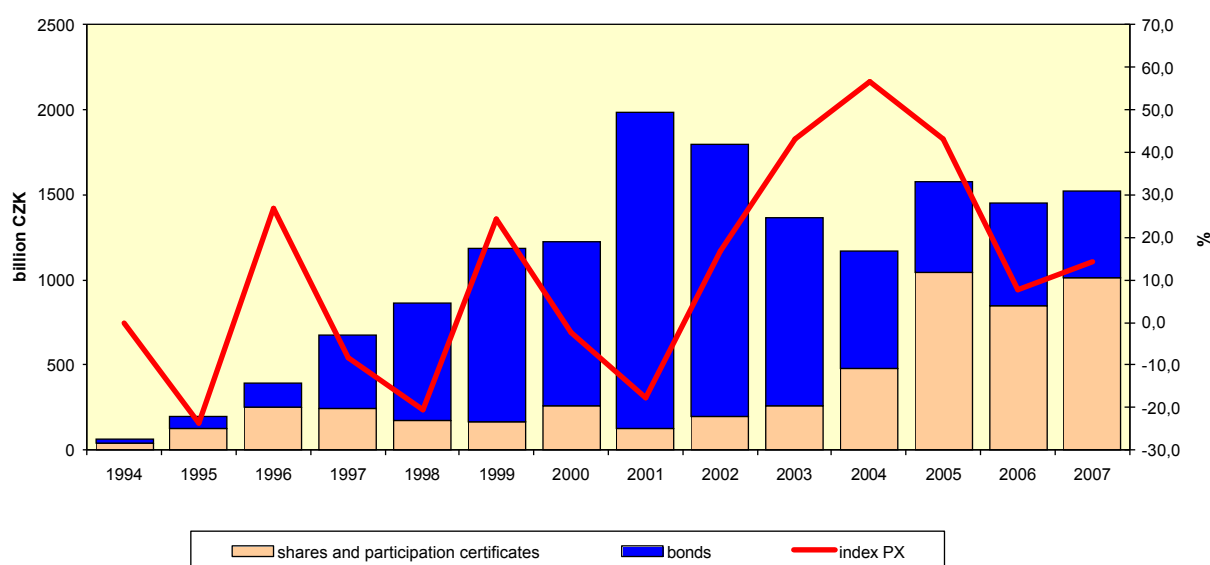
Table I.6.1 Development of dealings in the Prague Stock Exchange

Year	Total volume of Dealings (in billion CZK)	Number of emissions (At the end of the period)	Market capitalisation (billion, the state at the end of the period)	
			Shares + participation certificates	Bonds
1994	62,0	1 055	353,1	50,0
1995	195,4	1 764	478,6	87,8
1996	393,2	1 750	539,2	136,9
1997	679,5	412	495,7	174,0
1998	860,2	402	416,2	198,1
1999	1 187,5	290	479,6	231,1
2000	1 222,8	245	442,9	280,1
2001	1 987,2	186	340,3	319,4
2002	1 793,1	153	478,0	372,5
2003	1 367,5	146	644,5	505,5
2004	1 172,1	134	975,8	577,0
2005	1 574,4	135	1 330,8	x
2006	1 447,9	142	1 592,0	x
2007	1 521,9	164	1 841,7	x

Source: the PSE

Transactions with shares increased again...

The total volume of transactions on the Stock Exchange showed the year-on-year growth by 5.1 %. The deals in shares and participation certificates (66.6 %) were most involved in their transactions, which reached the second largest volume over the past 10 years, when year-on-year increased by 19.3 %. On the other hand, the volume of bonds traded was year-on-year lower by 15.0 %. An overview of the structure of the transactions on the Prague Stock Exchange shows the Figure No. I.6.2.

Figure I.6.2 Development of the main indicators of the Prague Stock Exchange
(dealings in billion CZK, the PX index of the inter-year-on-year changes in %)

Source: PSE, chart MIT

*... even the
derivatives were
dealt with*

In 2006, the Prague Stock Exchange **launched trading in derivatives**. In 2007, the futures in the amount of 1.9 billion CZK, certificates for 1.2 billion CZK and warrants for 32.9 million CZK were traded.

Shares of companies are the main titles on the Prague Stock Exchange:

- **ČEZ company**, which resumed in the implementation of its vision to become a leader in the energy markets in Central and South-eastern Europe. In addition to the production and sales of electricity also the area of telecommunications, information technology, nuclear research, design, construction and maintenance of energy facilities and mining as well belong to its activities. The acquisition of Polish hard coal power plants Skawina and Elcho became the biggest foreign investment of the ČEZ by means of which it entered the Polish strategic market and, in February 2007, became a part of the Warsaw Stock Exchange WIG 20; furthermore it also owns majority shares in three Bulgarian distribution companies and in the Bulgarian power plant in Varna. Even other companies based in Serbia and Kosovo facilitated the expansion of the ČEZ company; the company is also involved in Slovakia, Hungary, Netherlands, Romania, Macedonia, Bosnia, Serbia and other countries. The ČEZ extended its activities also in the Czech Republic, namely in the regional distribution of energy companies and increased its participation, for example in the North-Bohemian mines or Škoda Prague company. At the end of the year the ČEZ concluded an alliance with the MOL group; the joint venture will focus on building gas-fired power plants in the area of the MOL refinery in Bratislava and in the Hungarian Százhalombat. In January 2007, when the Energy Prague Stock Exchange was founded, the ČEZ claimed its right to perform the functions of the market maker, when he presumed to sell most of its production through the exchange. At the beginning of the year the shares of the ČEZ failed due to the mild winter, they grew, however in the coming months mainly due to the increased demand, growth of electricity prices and purchases of its own shares. In total, the company showed 41.9 % increase in the price of the shares for the year;
- **Telefonica 02 CR** is the most preferred telecommunication company in Central and Eastern Europe. It operates the largest fixed and mobile network and considers the broadband for a key instrument for the development of both. For the year 2007 it showed 14.5 % increase in the price of the shares. Along with a very low indebtedness of this company, its shares can be regarded as very prospective;
- **Unipetrol** - a group that was acquired by the Polish oil group PKN Orlen within the privatization of state shares (the largest processor of oil in Central Europe). The Unipetrol focuses mainly on oil manufacturing, distribution of fuel and petrochemical production, with an emphasis on strengthening the efficiency and profitability in all segments. A process of rebuilding the Benzina network continued, in August there was a merger of the companies Chemopetrol, a.s. Unipetrol Refineries, a.s. and Unipetrol RPA, s.r.o. into one company under the name of Unipetrol RPA, s.r.o. In November the Unipetrol bought from the Dutch company MIDDLE Europe Investments (MEI) 14.5 % shares of the refinery Paramo (oil processor focusing on the production of fuels, lubricants and asphalt) and its shareholding increased to about 88 %, with the aim of consolidating the position here and restructure it. The company reported increase in the share prices of 44.1 % for the year 2007, mainly due to high refinery and petrochemical margins;

- **Zentiva** – the development of which was positively affected by the results of the company in Poland, Russia and Ukraine, where it achieved the dynamic growth mainly through the introduction of new products and continuing investments in capacity in the area of sales and marketing. On the other hand, the Romanian sales and only slowly growing Romanian market, affected by the changes in the prices of medicines and the creation of margins of traders, caused a significant decline in its profits, in addition to the costs of the one-time writing-off for the outstanding claims in Romania. Consequently the shares of the pharmaceutical company decreased by 23.3 % in 2007. In early 2007 Zentiva announced the acquisition of Eczacibasi Generic Pharmaceuticals, one of the largest pharmaceutical companies in Turkey, and thus approached closer to a fulfilling its goal - to become the largest pharmaceutical company in Central and Eastern Europe. It entered also the Hungarian market with generic medicines. The shares of Zentiva were accepted also on the London Stock Exchange. The largest shareholders at the end of the year were Sanofi-Avensis (24.9 %) and Czech Insurance Company (15.3 %). The Zentiva completed the rapid expansion and now wants to concentrate on the strong consolidation of the group.

1.7. Results of the financial management in non-financial sector

Financial results showed high value levels

The financial results in the non-financial sector (with 50 or more employees – 9 806 entities) showed high values in the different sectors. A similar course as for the entire year of 2007 was, in itself, the fourth quarter except for the construction industry and agriculture, where, on the contrary, the year-on-year deterioration occurred. The overall positive results of non-financial sector are mainly owing to the growth of production and exports in the industry, positive development of the terms of trade and sales growth in the sector of trade and business services.

Flow financial indicators for organizations with 50 or more employees had the following year-on-year development:

The output continued to grow faster than the performance-related expenditure

The output in non-financial sector was positively influenced, in addition to the continued growth of production and exports in industrial branches, in particular, the year-on-year increase in export prices by 1.3 % and the year-on-year increase in prices of producers (agricultural producers by 16.8 %, industrial producers and construction works consistently by 4.1 % and market services by 1.6 %). The sales of the own products, which participated by 92.6 % in the overall output, grew by 9.7 % (418.3 billion CZK). The sales margin with a market share of 5.3 % in output grew by 11.5 %. Also a growth of inventories by 29.3 % was high. A lower growth in intermediate consumption than the output was positively affected by the year-on-year decline of 1 % in the import prices.

The Table I.7.1 documents the year-on-year comparison of development of the financial indicators for the non-financial sector.

Table I.7.1 Flow financial indicators and labour productivity in the non-financial sector
(organizations with 50 and more employees)

	Output including business margin		Intermediate consumption		Book value added		Labour productivity from book value added in current prices		Employment
	bill. CZK	year-on-year change in %	bill. CZK	year-on-year change in %	bill. CZK	year-on-year change in %	bill. CZK	year-on-year change in %	year-on-year change in %
Non-financial sphere	5 111,3	9,9	3 679,3	9,4	1 432,0	11,3	716,6	8,2	2,9
therein:									
Industry	3 500,5	9,2	2 651,0	8,6	849,5	11,1	810,8	9,1	2,0
Construction	383,4	8,4	309,2	7,6	74,2	12,2	669,5	14,3	-1,9
Trading and repairs of motor vehicles and consumer goods	349,0	10,4	198,5	10,4	150,5	10,6	636,5	3,3	6,9
Accommodation and catering	32,7	7,1	18,8	9,8	13,9	3,6	436,3	3,1	0,3
Transport, storage and communications	403,2	9,4	241,4	9,2	161,8	9,9	738,5	10,2	-0,3
Real estate, rental, business activities	243,3	21,9	141,4	29,4	101,9	12,8	566,4	0,8	11,9
Other services	96,9	11,6	48,0	4,0	48,9	20,1	509,2	8,6	10,5
Agriculture, forestry and fishery	102,3	10,5	70,9	10,2	31,4	11,2	368,2	19,6	-6,9

Source: Czech Statistical Office, MIT calculations

High growth in the book value added

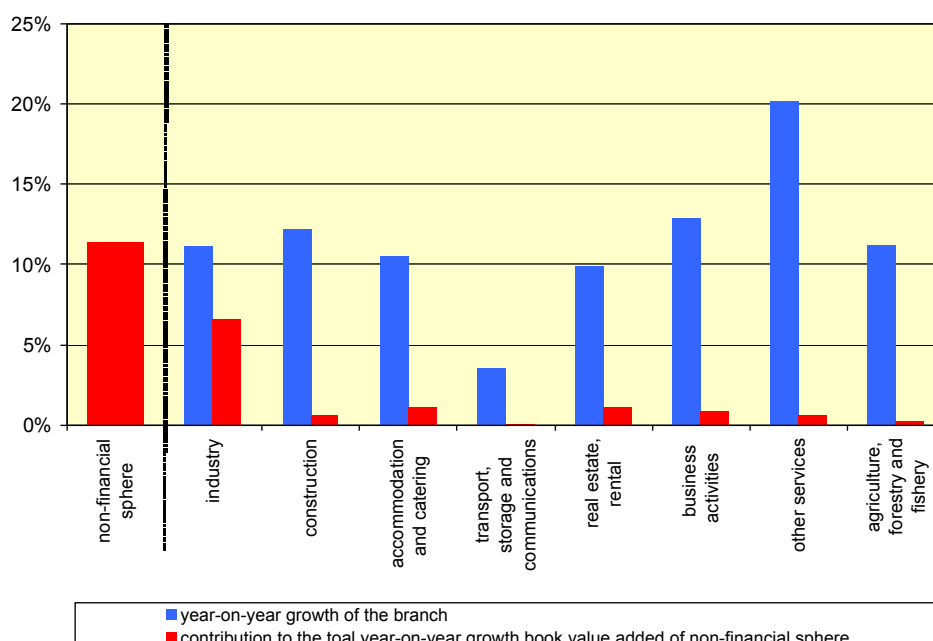
The book value added (in current prices) **maintained a strong rate of the year-on-year growth**, while developments in the various sectors did not show a big difference. A low growth in the book value added was noted only in hotels and restaurants thanks to the high growth intermediate consumption. This branch, however, does not have almost any effect on the overall performance of non-financial sector. Mostly the industry contributes to the growth of the value added in this sector, while maintaining completely dominant share in all financial indicators. The Table I.7.2 documents in basic financial indicators a comparison of the shares in the individual branches of the non-financial sector.

Table I.7.2 Shares of individual sectors in total non-financial sector results
(organization with 50 employees or more)

	Registered average number of employees.		Output including business margin,		Intermediate consumption		Book value added	
	2006	2007	2006	2007	2006	2007	2006	2007
Non-financial sphere	100,0	100,0	100,0	100,0	100,0	100,0	100,0	100,0
therein:								
industry	53,3	52,9	68,9	68,5	72,5	72,1	59,4	59,3
construction	5,9	5,6	7,6	7,5	8,5	8,4	5,1	5,2
trading and repairs of motor vehicles, consumer goods	11,0	11,5	6,8	6,8	5,3	5,4	10,6	10,5
accommodation and catering	1,6	1,5	0,7	0,6	0,5	0,5	1,0	1,0
transport, storage and communications	11,3	11,0	7,9	7,9	6,6	6,6	11,4	11,3
real estate, rental, business activities.	7,9	8,6	4,3	4,8	3,2	3,8	7,0	7,1
other services	4,4	4,7	1,9	1,9	1,4	1,3	3,2	3,4
agriculture, forestry and fishery	4,7	4,2	2,0	2,0	1,9	1,9	2,2	2,2

Source: Czech Statistical Office, calculations MIT

Figure I.7.1 shows the year-on-year change in the book value added by sector and their contribution to growth for the entire non-financial sphere.

Figure I.7.1 Book value-added, according to sub-sections of the manufacturing industry

Source: Czech Statistical Office, chart: MIT, calculation: MIT

The labour productivity and employment grew

A growth in the labour productivity from the book value added by 8.2 % in current prices was lower than the book value added because of the increase in employment by 2.9 %. The figure for productivity is slightly overestimated, however, because it does not take into account the persons temporarily assigned to enterprises through the work agencies³. A high year-on-year increase in productivity experienced those sectors where there was a decrease or low employment growth. This is mainly in the agriculture, construction and transport. Despite the two percents increase in employment the highest level of productivity in the long term was shown in the industry.

In terms of the institutional sectors, a sector of enterprises under the foreign control has been increasingly dominating in the financial results of the non-financial sector. For a comparison of the proportion of the institutional sectors in selected financial indicators see the Table I.7.3.

Table I.7.3 Shares of the institutional sectors in the overall results of the non-financial sphere
(organizations with 50 and more employees in %)

	Book value added		Employment		Output	
	2006	2007	2006	2007	2006	2007
Non-financial corporations	100	100	100	100	100	100
Non-financial public enterprises	10,5	10,0	10,9	10,5	6,2	6,8
Non-financial National corporations	41,8	38,8	52,7	50,0	41,4	38,2
Non-financial private corporations. under foreign control	47,7	51,2	36,5	39,4	52,4	55,0

Source: Czech Statistical Office, calculations MIT

³ In the non-financial sector there is about 71 thousand. workers (of which 52 thousand in the industry).

The best results were achieved by the sector under foreign control, mainly due to a high labour productivity, which significantly outpaced the national business sector, as well as the domestic public sector of the national enterprises (see Table I.7.4). A productivity growth in the non-financial sphere is higher than in individual sectors due to an increase of the share in employment in enterprises under the foreign control at the expense of the other two sectors with a lower productivity.

Table I.7.4 Labour productivity by the institutional sectors
(organization with 50 and more employees)

	Productivity from book value added In thousands CZK per employee		Index 07/06	Change in Employment
	2006	2007		
Non-financial corporations	662,5	716,6	8,2 %	2,9 %
Public non-financial corporations	643,2	682,1	6,0 %	-0,3 %
National non-financial corporations	525,3	554,1	5,5 %	-2,1 %
Private non-financial corporations. under foreign control	866,7	933,3	7,7 %	11,1 %

Source: Czech Statistical Office, MIT calculations

II. INDUSTRY

II.1. Production, employment and productivity

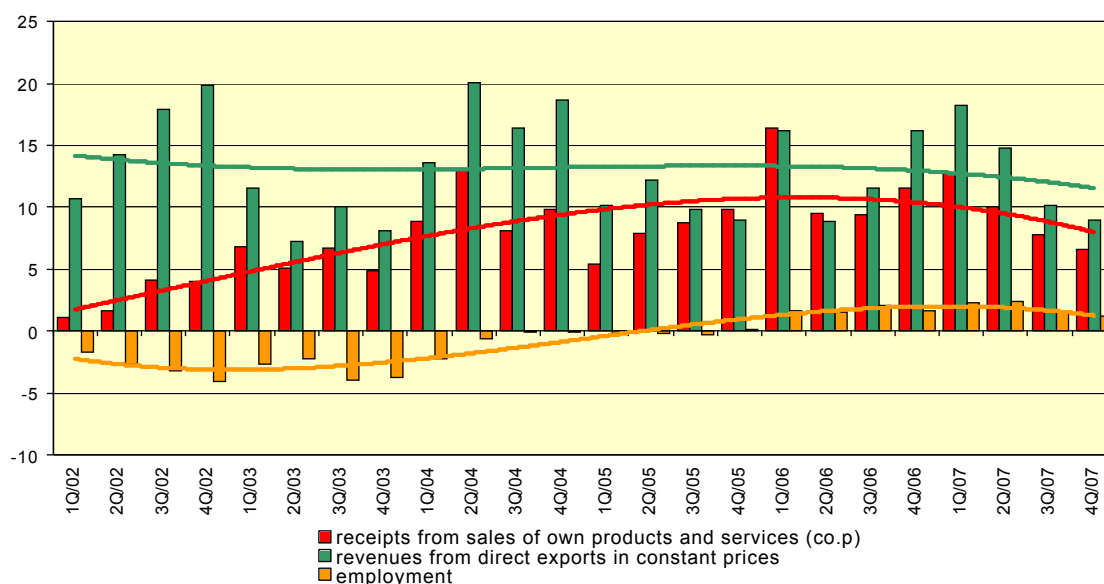
Despite a slight slowdown the industrial production maintained a high growth

The industry plays a crucial role in the economy of the Czech Republic (contributes by approximately 32 % in GDP). It belongs to the crucial holders of the economic activity and economic growth, high export performance and scientific and technological progress. Over the course of last five years it was reaching high growth rates, in 2007 the industrial production increased by 8.2 % (year-on-year slowdown in the growth of 3 p.p. was due to the lessening of growth of the economies in the EU countries and the high base of the previous year). The source of growth was the increasing production of previously realized and the newly accrued production capacities, particularly in rubber and plastics industry, mechanical engineering, electronic and computer and automotive industry, which were driven by a high demand. In parallel, other downstream industries developed. The companies under foreign control were a main holder of the growth by affecting, to a large extent, the development of the industry (in total sales participated by 60.2 %) and creating new jobs.

Within the manufacturing industry structural changes continued, which resulted in the growth of the share of the branches, manufacturing technologically sophisticated products with a higher value added and a lower intensity for the consumption of energy.

The sales (in constant prices) increased by 9.3 % and outpaced the growth of production, which argues in favour of the increasing competitiveness, where production finds a wider usage both on the domestic and foreign markets. Sales from direct exports (in constant prices) rose by 13 % (and participated by 56.2 % in the total sales). A more detailed overview on the shares revenues from direct exports in total sales and sales of sections is shown in the Table II. Industry, in the Annex.

Figure II.1.1 Development of sales and employment including trends (year-on-year % change)



Source: CZSO, calculations and graph MIT

Production for the long-term consumption was growing fastest

Production for the long-term consumption in the structure of **main industrial groupings** grew rapidly by 17.7 % in 2007 as a result of increased interest in consumer demand supported by growth in salaries. The continued high investment activity in the economy resulted in the increase of **production for investments** by about 14.4 % and the cooperation in the framework of multinational companies generated the growth of production of **intermediate products** by 8.7 %. As to the other groupings a moderate growth of **production for short-term consumption** of 1.2 % was seen, while production **for the generation** of energy decreased by 0.9 %.

Table II.1.1 Development of industrial production acc. to main industrial groupings
(year-on-year change in %)

	Scales Year 2000	Year						2007			
		2002	2003	2004	2005	2006	2007	1. Q	2. Q	3. Q	4. Q
Industry in total	100,0	1,9	5,5	9,6	6,7	11,2	8,2	11,6	9,1	6,1	6,2
thereof:											
for input	40,7	3,1	8,4	11,6	1,5	8,7	7,1	13,2	8,7	5,3	2,0
for investment	23,6	2,1	6,6	15,9	17,0	20,5	14,4	15,1	14,4	13,9	14,0
for long-term consumption	3,1	-8,2	-6,8	21,6	22,4	31,5	17,7	22,1	6,7	10,0	29,0
for short-term consumption	17,5	1,6	-1,2	-0,5	1,8	1,0	1,2	4,6	3,9	-0,5	-3,0
for energy production	15,1	1,0	5,8	1,4	3,1	2,3	-0,9	2,1	1,7	-6,1	-1,7

Source: CZSO

Table II.1.2 Industrial production and sales in 2007
(organization with 20 or more employees, year-on-year % change)

	1. Q	2. Q	3. Q	Oct.	Nov.	Dec.	4. Q	Year 2007
Industrial production index								
Industry in total	11,6	9,1	6,1	8,4	6,7	2,9	6,2	8,2
C Mining and quarrying	2,3	2,1	-0,3	-2,1	-3,5	-6,1	-3,8	-0,7
D Manufacturing industry	13,3	9,7	6,8	8,8	6,9	2,9	6,4	8,9
E Production and supply of electricity, gas and water	-4,7	2,8	2,8	7,2	7,2	5,6	6,6	1,6
Receipts from sales of own products and services (in constant prices)								
Industry in total	12,7	10,1	7,8	9,3	7,6	2,4	6,6	9,3
C Mining and quarrying	1,8	4,1	-7,1	-5,5	-7,5	-3,4	-5,5	-2,0
D Manufacturing industry	14,5	10,6	8,0	9,6	7,9	2,1	6,7	9,9
E Production and supply of electricity, gas and water	-5,5	4,6	10,0	11,8	8,8	7,4	9,1	3,9
Revenues from direct exports (in constant prices)								
Industry in total	18,2	14,8	10,2	12,8	11,0	1,9	9,0	13,0
C Mining and quarrying */	113,6	58,3	-11,2	5,3	0,7	-11,9	-1,7	22,5
D Manufacturing industry	17,8	14,6	10,6	12,8	11,0	1,8	9,0	12,9
E Production and supply of electricity, gas and water	21,8	7,0	-6,6	33,1	36,7	42,5	37,6	14,2
Share of revenues from direct exports (in constant prices) in the total revenues of the section (in %)								
Industry in total	57,2	56,7	55,5	56,6	57,3	51,8	55,4	56,2
C Mining and quarrying	25,4	26,1	25,6	25,1	25,9	22,0	26,1	25,4
D Manufacturing industry	61,4	59,9	58,8	60,1	61,1	56,8	59,5	59,9
E Production and supply of electricity, gas and water	4,4	5,7	6,1	5,7	6,0	5,3	5,6	5,4

Source: CZSO

*/ Changing trade organization of a major manufacturer was a result of the conversion from indirect to direct export in June 2006

Raw-material section showed a decrease in production and sales

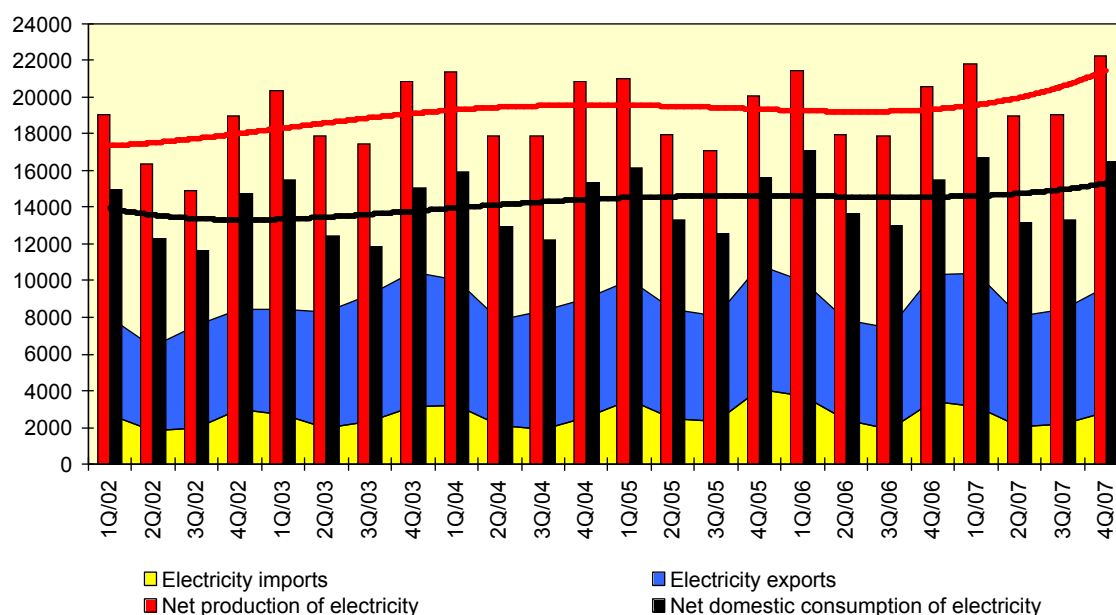
The production in the **section of the raw material** decreased by 0.7 % (while the extraction of energy raw materials decreased by 3 %, other mining and quarrying was higher by 4.4 %), sales decreased (in constant prices) by 2 %, while sales from direct exports (in constant prices) rose by 22.5 % (participated by 25.4 % in receipts from sales of own products and services).

The brown coal mining increased by 0.5 % in the physical units within the **production of solid fossil fuels, out of which** the brown industrial coal by 2.5 % (94.2 % share), for sorted coal decreased by 18.7 %. The mining of the hard coal showed a decrease of 3.7 %, out of which the coal suitable for coking by 0.8 % (59.5 % share) and the mining of hard energy coal by 7.6 %.

Mining and quarrying of **other minerals** was affected by a **favourable development in the building industry**, where a growth was shown for mining and dressing of limestone, plaster and chalk by 6.2 % and mining and dressing stone for the construction by 5.2 %. A high growth was noted in mining and dressing of non-classified minerals (graphite, mica, quartz and quartzite, asbestos, talc, feldspar, etc.) by 25.4 %.

The changing structure of industrial production resulted in the reducing energy intensity and **changes in the structure of energy consumption in favour of finer species**. When compared to 2000, in 2005 (latest available data) the consumption of liquid fuels increased by 19.9 % in the industry (share in the total consumption of fuels and energy 10.7 %), electricity by 18.9 % (17.9 % share), gas fuels by 15.3 % (26.7 % share) and solid fuels by only 2.5 % (19.6 % share), while thermal energy showed a decrease by 13.7 % (25.1 % share).

Figure II.1.2 Development of the net production, consumption, exports and imports of electricity (GWh)



Source: Czech Statistical Office, MIT chart

The growing economy resulted in a higher production and consumption of electricity

The economic boom positively resulted in the **energy section** by increasing its production by 1.6 %, sales (in constant prices) by 3.9 % and sales from direct exports (in constant prices) by 14.2 %. (in receipts from the sale of own products and services participated by 5.4 %). The **net generation of electricity increased** by 5.4 % in the physical units, out of which the combustion power by 8.9 % (share increased by 2.1 p.p. to 66.2 %); as to the other types of power plants a significant growth was shown in wind energy by 154.5 % (their share was very small - 0.2 %). In the case of nuclear power there was a slight growth of 0.5 % (share decreased by 1.5 p.p. to 30 %). The reason for that was the shutdown in the Temelin power plant during the springtime, when the turbine on the second block had to be upgraded (in addition to the regular exchanges of fuel) with the aim of increasing power (similar shutdown took place in August and September on the first block). **Positive developments resulted in the growth of net electricity consumption** by 0.7 %, primarily thanks to major customers (wholesalers), with growth of 3.4 % (58.8 % share). The retail consumption decreased by 3 % and by the structure the consumption of households was lower by 3.6 % (64.9 % share) and retail businesses by 1.8 %. The total exports of electricity, including transit was higher by 9.4 % (32.1 % of net production) and total imports, including transit decreased by 10.2 % (12.4 % of net production).

As to the various segments of the national economy the proportion of electricity consumption in industry in the total final consumption of electricity was 42.6 % (year-on-year increase of 2.4 p.p.), households 27.3 % (less by 0.4 p.p.), transport 4.1 % (reduction by 1.2 p.p.), agriculture and forestry 2.2 % (an increase of 0.2 p.p.), construction 0.8 % (stagnation) and the other branches in total 23 % (reduction by 0.9 p.p.).

The manufacturing industry was the holder of the growth, where the companies under foreign control showed a high performance

Within the manufacturing industry there was a dynamic growth of branches with a **high proportion of foreign investment** and export-oriented production. In terms of volume of exports (of goods under the foreign trade structure as per SITC) the most important were road vehicles (409.5 billion CZK, the share of 16.6 % in the total exports), electrical equipment, apparatus and appliances (229.4 billion CZK, share 9.3 %) and office machines and equipment for automatic data manufacturing (181.5 billion CZK, the share of 7.4 %). The manufacturing industry showed a production growth of 8.9 % sales (in constant prices by 9.9 %) and sales from direct exports (in constant prices) by 12.9 % (participated by 55.5 % in the industry and by 59.9 % in sales of the section within the total receipts from sales of own products and services).

Production of rubber and plastic products was influenced by the development of the automotive and electrical technical industry

Within the manufacturing industry the production of **rubber and plastic products** developed most dynamically. Its rapid growth, supported by foreign capital, coincided with a sharp development of the automotive, electro technical industry, engineering and packaging industries. Not only the domestic demand was higher for the production of plastics on the side of a favourably developing construction and other sectors, but also foreign demand (plastics in primary and non-primary form) grew. The production of the branch increased by 19.7 %, sales (in current prices) by 19.6 % and sales from direct exports (in current prices) by 16.2 % (participated by 50.5 % in receipts from sales of own products and services within the branch).

Out of the various product groups a high growth of 66.2 % was noted in the manufacture of plastic goods (5 % share), in the manufacture of plastic products for the construction - by 31.3 % (10.2 % share), in the production of plates, foil and hoses - by 25.1 % (8.5 % share), in the manufacture of plastic packaging - by 21.2 % (7.7 % share) and other goods in the production of plastics (plastic parts

and transport vehicles accessories) - by 17.5 % (23.1 % share). The production in the manufacture of tyres and air cells - which is a decisive product group - increased by 6 % on the year-on-year base (32.1 % share). A wide range of the application use of rubber and plastics in various branches including their use as a packaging material, made favourable conditions for further dynamic development.

Growing foreign demand for the production of the engineering industry

The production from the production capacities of foreign investors in industrial zones and high foreign demand from the most important business partners (the growth of exports of metal manufacturing machinery - by 21.2 %, machinery for the industrial branch - by 19.2 %, machinery and equipment for energy generation - by 16.2 % and machinery and equipment generally used in the industry - by 14.5 %) positively resulted in the **manufacture and repair of machinery and equipment**. Their output increased by 17.5 %, sales (in current prices) by 17.5 % and sales from direct exports (in current prices) by 18.7 % (participated by 69.2 % in receipts from the sale of own products and services within the branch). Foreign investors brought sophisticated technique, high-tech, and better organization of work into the branch, which helped to increase its competitiveness. It was further ensured by raising the technical level of final products, quality care, and a flexible response to customers' requirements and by available and fast service.

As regards the major sectoral fields, a high year-on-year growth was achieved in manufacturing of electrical household appliances - by 22.9 % (4.5 % share), pumps and compressors - by 21.7 % (9.7 % share), the production of other special purpose machinery - by 21 % (share of 9.7 %) and production of cooling, ventilation and air-conditioning equipment - by 14.3 % (15 % share). The manufacturing of machinery and equipment for general purposes grew very rapidly - by 57 % and production of machinery for certain economic sectors by 30.8 %, but a share of both was low (0.6 % respectively. 0.9 %). An increased demand resulted in the uprise of the total newly concluded contracts and orders from abroad.

Electrical industry was affected by a higher demand from the engineering and automotive industry

The entry of foreign multinational companies into the branches producing consumer electronics, electrical machinery and apparatus and computers, along with the manufacture of new production capacities (the industry with a high proportion of companies under foreign control) resulted in a dynamic growth of production of **electrical and optical equipment** by 15.7 %. The receipts from sales (in constant prices) increased by 13.5 % and sales from direct exports (in constant prices) by 10.6 % (participated 55.8 % in receipts from sales of own products and services within the branch). Both the foreign and domestic demand of businesses and people for sub deliveries in this branch on the part of the engineering, automotive industry and other industries developed favourably.

The individual sections of the manufacturing branch retained a high growth; production of medical, precision and optical instruments, watches and clocks (NACE 33) - by 19.2 % (9.5 % share), manufacture of business machines and computers (NACE 30) - by 17.8 % (share of 27.3 %), production of radio, television and communication equipment (NACE 32) - by 15 % (24.8 % share) and production of electrical machinery and apparatus (NACE 31) - by 14.7 % (38.4 % share).

A growth of the production in building industry brought forward the development in the manufacture of other non-metallic mineral products

The production of other non-metallic, mineral products rose by 14.3 %, sales (in constant prices) by 14.2 % and sales from direct exports (in constant prices) by 7.9 % (the receipts from sales of own products and services participated by 44.5 % in the income of the branch). Developments in this sector were influenced by favourable conditions at the beginning of the year for the expansion of construction works by the economic recovery in the neighbouring countries (Germany, Poland) and uncertainty regarding the change of the VAT. The production in the first quarter of 2007 was higher by 30.7 %; however, over the course of next quarters the growth was slowing up to 4.8 % in the 4th quarter of 2007.

By the breakdown of various product groups a high growth was shown in the manufacturing of products made of concrete, cement and plaster – by 87.2 % (1.4 % share), plaster products for construction purposes - by 55.3 % (1.2 % share), building components made of concrete - by 41.8 (share of 16.4 %), bricks, coverings, stoneware - by 31.3 % (4.8 % share) and the production of cement - by 22.2 % (7.7 % share).

Automotive industry influenced by the production and sales success of the Škoda Auto and TPCA Kolin

The crucial industry, **manufacturing of means of transportation** showed an increase in the production and sales (in constant prices) consistently by 13.9 %, sales from direct exports (in constant prices) - by 17.1 % (receipts from sales of own products and services participated by 76.3 % within the branch, while the majority of production was for export). Manufacturers and suppliers were successful in achieving **very good results** despite the stagnant demand in Western Europe and the downturn of the German car market. On the basis of the Association of Automotive Industry (SAP) the production of motor vehicles increased by a total 9.9 % (943 117 vehicles), of which 93.2 % were intended for export. The production of passenger cars increased by 9.7 %, with a share of 98.8 % in the total number of vehicles (Skoda Auto - 12.1 % increase in production, TPCA Czech Ltd. Cologne - 5.1 %). As regards the other categories, production of trucks increased by 58.3 %, buses by 13.9 % and motorcycles and mopeds by 122.7 %. Sales of cars in of the Skoda Auto factory rose in the international markets by 14.5 % (630 032 vehicles) and overcame all expectations.

A new Hyundai car factory in Nošovice (construction started in the first half of 2007), which will commence the trial operation in September 2008 and series production of automobiles in March 2009, will be a new impetus for further development of the automotive industry in the Czech Republic. It can therefore be assumed that the boundaries of 1 million vehicles produced will be exceeded for the first time in 2008.

Development of timber industry was affected by the calamity situation at the beginning of the year

Solutions of the calamity situation at the beginning of the year (hurricane "Kyrill") and the increased demand resulted in the increased production output in wood manufacturing, manufacture of timber products - growth by 8.7 %, receipts from sales (in constant prices) by 8.4 % and sales from direct exports (in constant prices) by 6.6 % (participated by 53.6 % in for sales of own products and services of the branch). The branch has an export nature and its production is largely (in assortments with the lower degree of manufacturing) oriented to Germany and Austria (more than 90 %).

The highest increase was reported for the production of wooden pallets, including packaging by 29 % (5.5 % share), as regards the other branches, a high growth was shown in the production of scale boards and plywood products - by 11.2 % (26 % share) and sawmill production and impregnation of wood - by 7,8 %

(33.8 % share), the production of which is either a half-finished product for further manufacturing or final product for needs of the construction, mining and traffic engineering. As to the other major fields of production increase manufacture of building joinery - by 3.5 % (28.8 % share).

*A higher growth
in the furniture
production and
recycling of
secondary raw
materials*

As regards the manufacturing industries not listed elsewhere, the production increased by 6.4 %, receipts from sales (in constant prices) by 5.7 % and revenues from direct exports (in constant prices) by 8.9 % (receipts from sales of own products and services participated by 65.8 % in the branch). The decisive role is played by the production of furniture as per NACE 36.1 (its share in NACE 36 is approx. 70 % in decisive indicators in the long term) with the growth of production by 6.5 %. The production of kitchen furniture developed dynamically and increased by 23.9 %, as regards the other fields, the production of gold and jewellery articles - by 15.2 % and production of games and toys - by 10.3 %.

The increased pressure on the management of non-renewable raw material resources in the principles of sustainable development resulted in the recycling of secondary raw materials (NACE 37) by the growth of 6 % (12 % share), where the manufacturing of non-metal material and the residuals increased by 17.4 % and metal material 5.8 %.

*Increased demand
for main
packaging
products*

The production branches of **pulp, paper and paper products, printing, publishing and print**, which is based on renewable sources of the domestic origin and products of which are used not only in manufacturing, showed the production increase by 5.4 %, receipts from sales (in constant prices) rose by 5.1 % and sales from direct exports (in constant prices) by 12.7 % (receipts from sales of own products and services participated by 43.2 % in the branch). Developments in the manufacture of **pulp, paper and paperboard** (NACE 21) were influenced by increased demand for packaging products for expanding manufacturers (automotive, electrical industry) and the production increased by 6.3 % (58.8 % share). The production of pulp, paper and paperboard grew dynamically by 81.3 % and production of corrugated paper, paperboard and packaging material by 8.3 %.

As for the **publishing, printing and reproduction of recorded media** (NACE 22), the production increased by 3.4 % (41.2 % share), where growth was shown for print by 21.6 % and for newspapers and other publishing (postcards, calendars, paintings and drawings) by 18.3 %. The pirate copying and illegal sale, despite the protectionist measures, limits the growth of production and sales of the recorded sound media. The newly concluded total contracts in the production of pulp, paper and paper products increased by 8 %, from abroad by 11.9 %.

As for the other branches a slight increase in production was showed in the manufacture of **textiles and textile products** - by 1.6 %, **production of chemicals**, preparations and **pharmaceutical products** - by 1.2 % and manufacture of **leather and leather products** - by 0.9 %.

Developments in the **textile and clothing and leather industry** have long been negatively influenced by more favourable (in terms of price) imports from Southeast Asia. The textile and clothing industry is driven by those textile factories, which benefit from contracts with the automotive industry, while the production of clothing companies declines.

The relatively low growth in **production of chemicals, preparations and pharmaceutical products** was caused by nearly two-monthly shutdown of the petrochemical and refinery operations in a newly established company UNIPETROL RPA, s.r.o. for the purpose of a repair and modernization of plants, which was, in addition, complicated by several smaller accidents in the start-up

operations and the year-on-year results were worsened also by lower petrochemical margins.

The decrease in the production of three branches

Within the manufacturing industry the production decreased in three sectors, in the **production of coke and petroleum products refining** (by 4.3 %), **basic metals and fabricated metal products** (by 0.6 %) and **food products and beverages** (by 0.2 %).

The **coking and petroleum refining** were affected by the planned shutdown of the refineries in the second half of the year (production in the 2nd half of 2007 decreased by 17.3 %). The refinery inputs (when imports reduced by 7.5 %) in 2007 were lower by 6 %. As for the **production of basic metals, metal products and fabricated metal products**, the production of **basic metals and metal products** decreased (NACE 27) by 11.9 % (44 % share), while the manufacture of **fabricated metal products** (NACE 28) was higher by 18.3 % (56 % share). A slight decrease in the production of **food products and beverages** was influenced by the decisive reduction in the production of poultry meat by 4.8 % (pig meat production increased by 2.4 % and beef and veal 0.2 %).

Table II.1.3 Development of the industrial output broken down by the economic activity
(organization with 20 or more employees, year-on-year % change)

	2004	2005	2006	2007				
				1. Q	2. Q	3. Q	4. Q	year
Industry in total	9,6	6,7	11,2	11,6	9,1	6,1	6,2	8,2
Mining and quarrying	-0,6	0,5	2,5	2,3	2,1	-3,0	-3,8	-0,7
Out of which:								
Mining of energy-base material	-2,2	-0,2	0,6	-4,1	-0,3	-5,7	-1,8	-3,0
Mining and quarrying of other raw materials	3,8	2,4	7,2	24,9	7,1	1,9	-8,3	4,4
Production and distribution of electricity, gas and water	0,9	-1,2	2,6	-4,7	2,8	2,8	6,6	1,6
Manufacturing industry	10,7	7,5	12,1	13,3	9,7	6,6	6,4	8,9
Out of which:								
Production of food., beverages and tobacco products	-1,4	-2,8	1,4	1,7	0,8	-1,2	-1,9	-0,2
Production of textiles and clothing products	-0,2	-2,6	-2,4	7,1	4,4	0,7	-6,8	1,6
Manufacture of leather and leather products	-0,5	3,3	1,2	2,0	0,4	-4,2	4,5	0,9
Wood manufacturing and wood products manufacture except furniture	6,6	6,2	9,9	20,8	10,4	7,8	-2,3	8,7
Manufacture of pulp, paper and paper products	7,3	6,0	1,1	6,4	5,3	5,4	4,3	5,4
Manufacture of coke, refinery manufacturing of oil	4,0	12,6	2,6	19,9	0,9	-17,7	-16,8	-4,3
Production of chemicals, preparative and fibres	11,4	5,7	2,1	5,8	7,7	-1,7	-8,1	1,2
Production of rubber and plastic products	11,0	12,6	15,3	27,6	21,6	19,4	10,6	19,7
Manufacture of other non-metal products	7,8	3,0	1,7	30,7	15,0	11,0	4,8	14,3
Production of basic metals and fabricated metal products	9,3	-0,9	9,1	4,0	-1,6	-3,4	-1,4	-0,6
Manufacture and repairs of machinery and equipment.	14,3	14,1	20,8	24,8	18,1	17,5	11,2	17,5
Production of electrical and optical equipment	29,2	5,0	21,0	22,0	17,0	14,1	12,0	15,7
Manufacture of transport equipment	13,2	23,0	22,2	11,6	13,1	12,8	18,0	13,9
Manufacturing industry not specified elsewhere	7,9	8,6	9,7	23,6	10,4	1,9	0,4	6,4

Source: CZSO

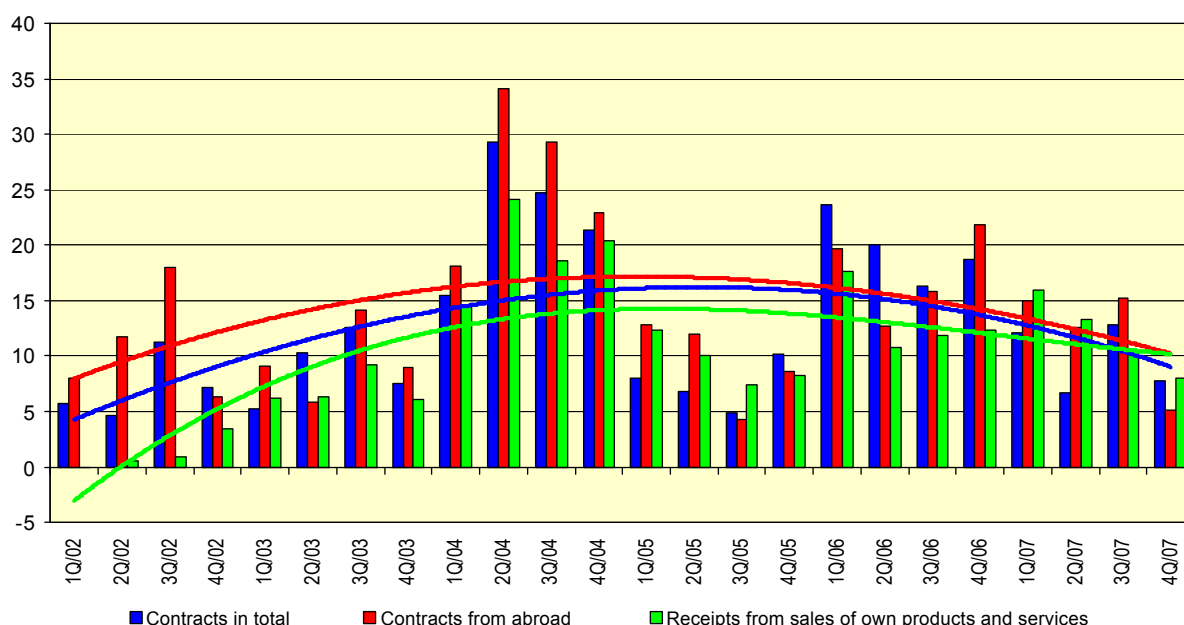
A strong foreign demand accounted for growth in newly closed contracts

A tight linkage between the growth in the industrial production and newly concluded contracts shows the export possibilities of the individual branches within the manufacturing industry. The development of concluded contracts resulted in the growth dynamics slowing of the industry. The newly concluded **contracts in total** (in selected NACE with a share of 60 % in the total industry

sales), **increased** by 9.8 % (the year-on-year reduction in growth by 9.9 p.p.), out of which **orders from abroad** by 11.8 %, receipts from sales in selected sections (in constant prices) were higher by 11.6 % (a reduction in growth of 1.1 p.p.).

The largest **volume of total orders** was realised in the production of motor vehicles (28.2 % share), manufacture and repair of machinery and equipment (14.2 % share), the production of basic metals products (11.6 % share) and in the manufacture of electrical machinery and equipment (10.2 % share). A considerable increase in total orders was achieved in the manufacture of other means of transport – by 32.8 % and in the manufacture of medical devices and equipment - 28.7 %.

Figure II.1.3 Development of new contracts and sales for selected sections, including trends
(monitored only for NACE 17,18,21,24,27-35, year-on-year % change in current prices)



Source: Czech Statistical Office, chart MIT

As regards the **newly concluded contracts** from abroad (the share in the total contracts 64.6 %) the largest volumes were realized, likewise the total procurement, in the production of motor vehicles (31.6 % share), manufacture and repair of machinery and equipment (15.1 %) and in the manufacture of electric machinery and apparatus (10.6 % share). As for the individual selected sections, foreign contracts grew dynamically for the manufacture of medical, precision and chronometric instruments - by 32 % and for manufacture and repair of machinery and equipment of 23.4 %.

The drop in the overall orders was noted in the manufacture of clothing, dressing and dyeing of furs by 3.5 % (out of which orders from abroad by 3.4 %).

A proportion of technologically sophisticated industries with a higher value added was increasing in the long run

Within the structural changes in the industry, **influence of the manufacturing industry further strengthened**, its share in the total industry receipts from sales increased to 92.6 % (year-on-year increase by 0.5 p.p.), while the energy section declined to 5.5 % (by 0.3 p.p.) and the raw materials section to 1.9 % (by 0.2 p.p.). The structural changes continued in connection with the influx of foreign capital of other investors and onset of the new production capacities. At the same time, **technological level of production**, making products with a **higher value added**, increased which contributed to the **increasing competitiveness** (particularly on

foreign markets). Within the scope of the manufacturing industry a proportion of the five branches (mostly reaching very good results) - Table II.1.4), increased with their share of 58.6 % in the total sales (in 2006 it was 55.8 %).

Table II.1.4 Structure of the industry according to receipts from sales of own products and services
(organization with 20 employees or more, shares in % from constant prices)

	2003	2004	2005	2006	2007	Change 2007- 2006
Industry in total	100,0	100,0	100,0	100,0	100,0	
Mining and quarrying	2,7	2,4	2,1	2,1	1,9	-0,2
Out of which:						
Energy-base material mining	2,2	1,9	1,7	1,6	1,5	-0,1
Mining of other raw materials	0,5	0,4	0,4	0,5	0,4	-0,1
Production and distribution of the electricity, gas and water	7,6	6,5	6,4	5,8	5,5	-0,3
Manufacturing industry	89,7	91,2	91,5	92,1	92,6	0,5
Out of which:						
Production of food., beverages and tobacco products	10,8	9,8	8,8	8,1	7,4	-0,7
Production of textiles, textile. and clothing products	3,0	2,6	2,3	2,0	1,9	-0,1
Manufacture of leather and leather products	0,2	0,2	0,2	0,1	0,1	0,0
Wood manufacturing and production except furniture	1,7	1,8	1,7	1,7	1,7	0,0
Manufacture of pulp, paper and paper products	4,1	4,0	3,9	3,5	3,4	-0,1
Manufacture of coke, oil refinery manufacturing	3,1	2,5	2,3	2,0	1,7	-0,3
Production of chemicals, fibres and preparatives	5,4	5,5	5,4	5,0	4,6	-0,4
Production of rubber and plastic products	5,7	6,1	6,3	6,5	7,1	0,6
Manufacture of other mineral non-metal products	4,9	4,8	4,6	4,2	4,3	0,1
Production of basic metals and fabricated metal products	12,2	12,1	11,3	11,0	10,4	-0,7
Manufacturing and repairs of machinery and equipment not elsewhere specified	6,6	7,1	7,5	8,1	8,7	0,6
Production of electrical and optical equipment	12,7	14,8	14,9	15,9	16,5	0,6
Manufacture of transport equipment	16,3	16,9	19,3	21,1	22,0	0,9
Manufacturing industry not elsewhere specified	2,9	2,9	2,9	2,8	2,7	-0,1

Source: CZSO

Note: differences, if any, result from the computer alignment

The increased demand and expanding production accounts for the employment growth

New investments, ongoing structural changes and continued high demand (especially foreign) resulted in the **employment growth in the industry** (since mid-2005, selected branches have been becoming saturated with the labour force). In the course of the scarce resources of labour force the businesses approached work agencies for recruiting new staff, which usually took new employees abroad.

In 2007 the industrial enterprises employed 42 827 of **agency workers** (work agency staff signed on to work for the respondent for the main industrial activity), with the dynamic year-on-year increase by 26.4 %. As for the branches, the agency workers are most represented in most important branches, in the manufacture of electrical and optical devices – 11 160 employees and in the manufacture of transport equipment – 10 829 employees. Since the beginning of 2007, the agency staffs have been included (for the calculation of productivity at work) into the total number of employees.

Many **new jobs** will be generated by **new investments**, which will be soon implemented (for example, Hyundai Cars, electronics manufacturer Foxconn, manufacturer of electrical and automotive technology Siemens).

Table II.1.5 Selected indicators of industrial organization with 20 or more employees in 2007
(year-on-year change in % CZK)

Index	Year 2007 / Year 2006									Reality
	Industrial produkce (IPP)	Revenues from sales of own products and services in con. prices	Revenues from direct exports in con. prices	Registered number of employees	Labou productivity from revenues	Average nominal wage	Wage converted by producers price index	Unit labour costs		Average wage in CZK
								Nominal	Real	
Mining and quarrying	-0,7	-2,0	22,5	-5,4	3,6	7,1	0,2	3,4	-3,3	26004
Out of which:										
Energy-base material mining	-3,0	-1,5	29,7	-5,6	4,4	7,1	-1,6	2,6	-5,7	26351
Mining of other raw materials	4,4	-3,8	-4,8	-3,9	0,4	6,6	4,8	6,2	4,4	23775
Production and distribution of the electricity, gas and water	1,6	3,9	14,2	0,5	3,4	6,3	-1,0	2,8	-4,3	27924
Manufacturing industry	8,9	9,9	12,9	2,2	6,7	7,6	4,0	0,8	-2,6	20532
Out of which:										
Production of food., beverages and tobacco products	-0,2	-0,5	16,6	-3,6	2,6	5,7	1,2	3,0	-1,3	18673
Production of textiles, textile. and clothing products	1,6	0,6	-0,6	-8,0	9,4	7,5	7,0	-1,7	-2,2	13958
Manufacture of leather and leather products	0,9	0,8	4,1	-6,8	7,9	4,4	4,0	-3,2	-3,6	13270
Wood manufacturing and production except furniture	8,7	8,4	6,6	-0,4	8,6	7,1	2,1	-1,4	-6,0	17008
Manufacture of pulp, paper and paper products	5,4	5,1	12,7	0,7	4,2	6,9	4,0	2,6	-0,2	22595
Manufacture of coke, oil refinery manufacturing	-4,3	-4,4	-4,8	-1,1	-3,5	6,2	1,7	10,1	5,4	30096
Production of chemicals, fibres and preparatives	1,2	0,9	6,5	1,0	-1,4	5,7	2,6	7,2	4,1	24080
Production of rubber and plastic products	19,7	19,6	16,2	9,4	8,9	6,3	6,1	-2,4	-2,6	19726
Manufacture of other mineral non-metal products	14,3	14,2	7,9	0,1	13,8	8,7	3,1	-4,5	-9,4	21797
Production of basic metals and fabricated metal products	-0,6	2,8	8,8	3,2	-0,7	9,3	2,4	10,1	3,2	21003
Manufacturing and repairs of machinery and equipment not elsewhere specified	17,5	17,3	18,7	5,4	10,4	7,1	4,1	-3,0	-5,7	21437
Production of electrical and optical equipment	15,7	13,5	10,6	5,1	6,4	6,2	4,6	-0,2	-1,7	20084
Manufacture of transport equipment	13,9	13,9	17,1	4,8	7,6	7,8	9,0	0,2	1,3	24119
Manufacturing industry not elsewhere specified	6,4	5,7	8,9	-2,8	8,9	7,2	4,4	-1,6	-4,1	16778
Industry in total	8,2	9,3	13,0	1,8	6,6	7,4	3,2	0,8	-3,2	21048

Source: Czech Statistical Office, MIT calculations

Note: labour productivity index calculated as a percentage of sales of own products and services at constant prices and the index registering an average number of employees.

A higher labour productivity growth than in real wages

The ongoing structural changes taking advantage of new and improved technologies resulted in the labour productivity growth by 6.6 %. The highest level of labour productivity is in the branches where, are represented, at a higher level, mainly export-oriented companies under foreign control. A **growth in labour productivity outpaced the dynamics of real wages**, converted by industrial producer price index by 3.4 p.p., when converted by index of consumer prices - by 2.1 p.p..

Positive developments in sales and labour productivity (when employment increased), enabled businesses a faster growth in the **average nominal wages**, which reached 7.4 % (6 % in the same period of the previous year). A higher growth in nominal wages than the real growth in labour productivity resulted in an increase of the nominal unit costs by 0.8 %, while the real fell by 3.2 % (Table II.1.5. and Table II.1.6.). In 2006, this rate was more favourable, when the nominal unit costs decreased by 3.4 % and the real by 4.9 %. This indicates a worsening in the competitive conditions.

Table II.1.6 Development in the relation of wages and labour productivity (year-on-year % change)

	Line number	Year				2007				
		2003	2004	2005	2006	1. Q	2. Q	3. Q	4. Q	year
Average nominal wage	1	5,7	7,2	4,7	6,0	8,0	7,6	7,5	6,9	7,4
Average wage converted by producers price index	2	6,0	1,4	1,7	4,3	4,7	3,3	3,5	1,8	3,2
Labour productivity	3	9,5	10,5	8,2	9,7	9,4	7,0	5,5	4,7	6,6
Unit labour costs										
Nominal	1/3	-3,5	-3,0	-3,2	-3,4	-1,3	0,6	1,9	2,1	0,8
Real	2/3	-3,2	-8,2	-6,0	-4,9	-4,3	-3,5	-1,9	-2,8	-3,2

Source: MIT calculation based on the CZSO data

A significant growth in receipts from sales of organisations with 3000 – 3999 employees

Broken down by the size structure, the highest receipts from sales growth (in constant prices) was reached by the organizations with 3000 - 3999 employees, namely by 35.8 %, while increasing their contribution to overall sales by 1.5 p.p. to 5.6 %; a high growth was noted also for the employment - by 15.1 %. This size group is dominated, in particular, by the private enterprises under foreign control in the successful branches of the rubber industry, automotive industry, electric technical industry and engineering, with outstanding export opportunities, which showed a high growth of direct exports by 60.7 %. As for the other size groups, small organizations with 50 - 99 employees reached a high **sales growth** (in constant prices) by 17.1 %, small organizations with 20 to 49 employees reached the 15.6 % increase. The positive development of small organizations was facilitated by the contribution of the support programmes for small and medium-sized enterprises, responding to current needs of development and focusing on support for entrepreneurs in form of guarantees for bank loans, allowances and subsidies.

Table II.1.7 List of the key indicators by size categories in 2007

	Average number of enterprises	Revenues from sales of own products and services			Revenues from direct exports year-on-year change const. prices	Number of employees			Monthly average				
		bill. CZK in const. prices	share in %	Y-o-y change in const prices		in thousands of people	share in %	Y-o-y change	Revenues from sale / employee			Wage	
									in CZK in constant prices	Y-o-y change in const. prices	level average =100	in CZK	Y-o-y change
Enterprises with 20 or more employees in total	8624	3173	100,0	9,3	13,0	1167	100,0	1,8	211226	6,6	100,0	21048	7,4
20 - 49	4265	201	6,3	15,6	18,5	127	10,9	1,0	120588	14,5	57,1	17921	9,5
50 - 99	1976	223	7,0	17,1	17,8	140	12,0	3,7	126253	13,0	59,8	18422	10,2
100 - 249	1468	475	15,0	9,5	12,6	233	20,0	3,0	158105	6,4	74,9	19597	6,2
250 - 499	515	482	15,2	9,6	12,3	182	15,6	-0,8	211369	10,3	100,1	20544	7,5
500 - 999	264	553	17,4	3,4	7,0	185	15,9	0,3	236833	3,0	112,1	21829	6,5
1000 - 1999	94	414	13,0	11,3	17,8	126	10,8	3,9	275380	7,0	130,4	23521	5,2
2000 - 2999	20	206	6,5	-1,3	-2,0	47	4,0	10,4	372788	-10,6	176,5	22098	9,3
3000 - 3999	11	177	5,6	35,8	60,7	43	3,7	15,1	360034	17,3	170,4	22035	5,3
4000 - 4999	4	32	1,0	-16,2	-13,1	19	1,6	-17,0	136061	0,9	64,4	23185	14,1
5000 a více	6	410	12,9	6,6	11,1	65	5,6	-2,7	493023	9,6	233,4	30521	8,2

Source: the CZSO

*The long-term
high performance
of enterprises
under foreign
control continued*

The structure of industrial enterprises broken down by institutional sectors was dominated by the **high performance of private enterprises under foreign control** with a growth of 12.5 % and the increasing share of overall sales to 60.2 % (year-on-year increased by 1.6 p.p.). Their number almost doubled between 2000 and 2007 their share increased by more than a third. Companies under foreign control are significantly export-oriented and benefited from its connection to the parent company, which facilitate their access to foreign markets. Focusing on exports resulted in sales growth from direct exports (in constant prices) by 13.8 % and resulted on their high share in the sales of the branch (68.6 %) and in the total industry sales (43.6 %).

Putting the new production capacities of foreign companies in operation and expansion of the the production in the existing ones resulted in an increase in their employment by 10.2 % while a growth in the share of total industry employment was by 3.4 p.p. to 45 %.

Table II.1.8 Breakdown of key indicators by the institutional sectors in 2007

	Average number of entprises	Revenues from sales of own products and services			Revenues from direct exports Y-o-y change const. prices	Number of employees			Monthly average				
		in billion CZK current prices.	share in %	Y-o-y change constant prices		in thousands of people	share in %	Y-o-y change	sales per employee			wage	
									in CZK constant prices	Y-o-y change in const. prices.	level average =100	in CZK	Y-o-y change
Enterprises with 20 or more employees													
Employees in total	8624	3172,9	100,0	9,3	113,0	1167,1	100,0	1,8	211226	6,6	100,0	21048	7,4
11001 - public	124	140,2	4,4	7,5	111,4	32,2	2,8	-2,2	265953	9,9	125,9	27773	6,6
Non-public sphere	8500	3032,7	95,6	9,3	113,0	1134,8	97,2	2,0	217538	6,3	103,0	19788	7,0
Out of which:													
11002 – private, national	5799	1099,8	34,7	3,6	109,9	589,1	51,5	-4,2	140435	8,1	66,5	18926	6,5
11003 –private, under foreign control.	2093	1910,4	60,2	12,5	113,8	525,5	45,0	10,2	302345	2,1	143,1	23230	6,9
14000 - employers*/	609	22,6	0,7	6,4	127,2	20,3	1,7	-2,0	85938	8,5	40,7	15489	8,6

Source: CZSO

Note: Non-public sphere: count of 11002, 11003 and 14000

* / Individuals unincorporated enterprises with 20 or more employees

II.2. Financial situation of industrial enterprises

The financial results reached a high growth rate

The continued growth in industrial production positively resulted in the year-on-year high increase in financial indicators. Industrial enterprises benefited in the long term primarily from a higher foreign demand, which supports a high creation of new production capacities. **The best results in 2007 were achieved by the manufacturing industry**, and again its key sub-sections like the automotive industry, chemicals, engineering, electrical and technical and electronic industries and rubber and plastics industries. A nominal growth of the financial flow indicators was also seen in the energy and mining branch, however, as a result of high growth of the industrial producer price index in real terms these sections showed predominantly the year-on-year decline.

The results of financial indicators are being accounted for the organizations with 50 employees or more, which get involved by approximately 85 per cent in the overall results for the industry (in the book value-added, performance, power consumption).

The financial results of flow indicators in the organizations with 50 or more employees showed the following year-on-year development:

The book value reported a significant growth in the manufacturing industry

The book value added significantly increased in the manufacturing industry. Broken down by its industrial structure there can be seen, in terms of the year-on-year growth, two groups sub-sections (see chart No. II.2.1 and II.2.2). The first group with the growth around 20 % virtually reproduce the group of enterprises with a high performance. The only exception is the sub-section of the production of chemicals, where the performance increased as a result of organizational changes⁴, however a growth in value added was so small that this section included in the group with a lower growth.

Table II.2.1 Flow financial indicators and labour productivity in industry
(organization with 50 or more employees)

	Output including business margin			Performance-related consumption		Book value added			Labour productivity from book value added			Employment
	bill. CZK	y-o-y change in % curr. prices	y-o-y change in % real	bill. CZK	y-o-y change in % curr. prices	bill. CZK	y-o-y change in % curr. prices	y-o-y change in % real	per employee, in thousands CZK	y-o-y change in % curr. prices	y-o-y change in % real	y-o-y change in %
Industry	3 500,5	9,2	4,9	2 651,0	8,6	849,5	11,1	6,8	810,8	9,1	4,8	2,0
therein:												
Mining and quarrying	77,7	4,8	-2,0	37,5	7,0	40,2	2,7	-3,9	1 018,2	8,6	1,5	-5,4
Manufacturing industry	2 873,7	10,3	6,6	2 188,3	9,1	685,4	14,5	10,6	715,0	11,7	7,9	2,6
Production and distribution of electricity, gas and water	549,1	4,1	-3,1	425,2	6,0	123,9	-2,0	-8,8	2 497,5	1,2	-5,8	-2,8

Source: Czech Statistical Office, MIT calculations

The Table II.2.1 documents the year-on-year comparison of growth of the flow financial indicators (in 4 528 enterprises) under the industrial sections. The nominal growth is adjusted in real terms through the existing price indices, which are valid for individual sections. For the year 2007 the industrial producers price index reached 4.1 % (6.9 % in mining industry, 3.5 % in the manufacturing

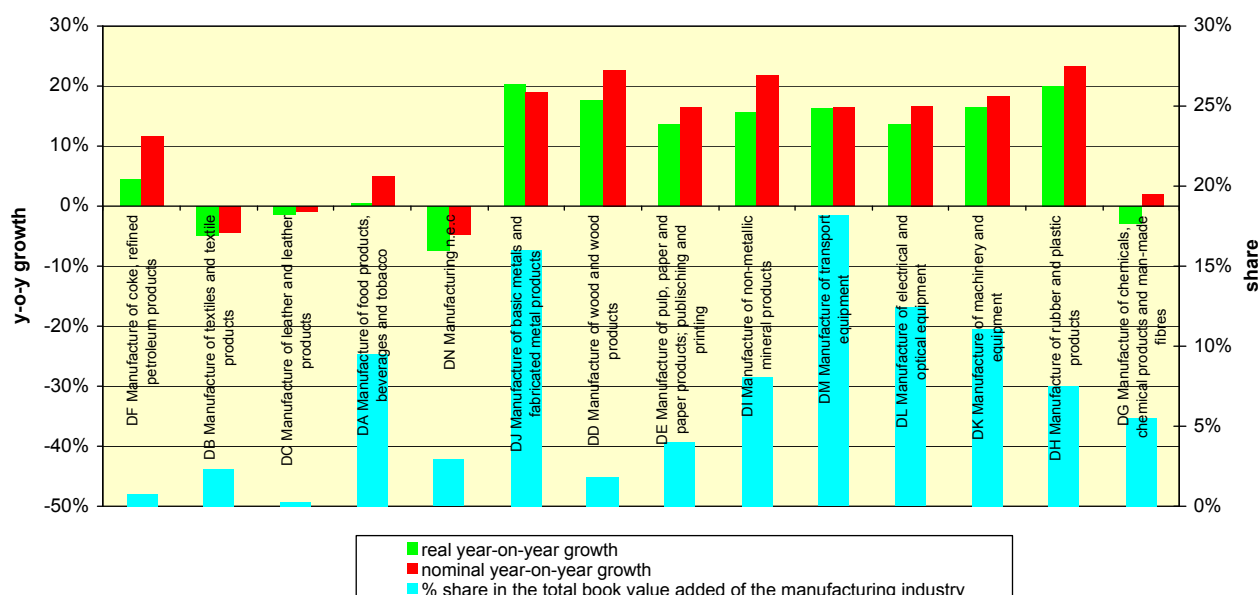
⁴ The growing performance in the chemical industry was influenced by the organizational changes (as of August 1, 2007 there was a merger of the company Chemopetrol, a.s. Unipetrol rafinérie, a.s., and Unipetrol RPA, Ltd. into the one company - Unipetrol RPA, Ltd.)

industry and 7.4 % in the energy section). This model calculation then uses these price indices for the book value.

The financial situation in the energy section was significantly influenced by the natural gas branch, the results of which, in addition to organizational changes, were affected also by the decrease in gas consumption due to the warm weather at the beginning of the year. The positive results of this section therefore primarily account for companies in the field of generation and distribution of electricity and distribution of water, which achieved the outstanding financial results amounted at current prices mainly due to the increasing prices of their products.

The raw materials mining section lately strengthened its financial position; mainly due to the increasing global demand for coal and thereby its increasing price.

Figure II.2.1 Book value-added according to the subsections of the manufacturing industry

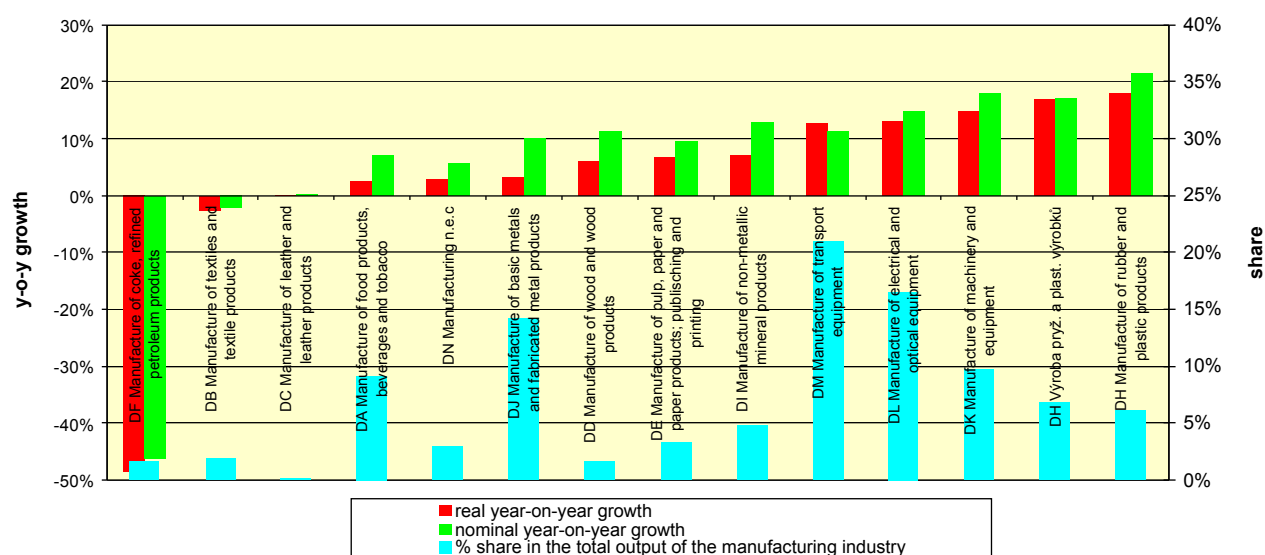


Source: Czech Statistical Office, MIT chart

A high growth of performance in the manufacturing industry

Solely the manufacturing industry was concerned with a high growth performance. The Figure II.2.2 shows a differentiated year-on-year development in performance (including trade margin) broken down by the individual subsections of the manufacturing industry. Their growth was positively affected by the increase in export prices by 1.3 %. In particular the branches with a high representation of foreign investors, which also occupy a significant share in the total output of the manufacturing industry, merited by their results in the growth of performance. A negative growth in the output was shown in the long-term stagnant textile industry and in the sub-section of coke production, nuclear fuels and oil refineries. These two subsections, however, have an inconsiderable proportion in the manufacturing industry.

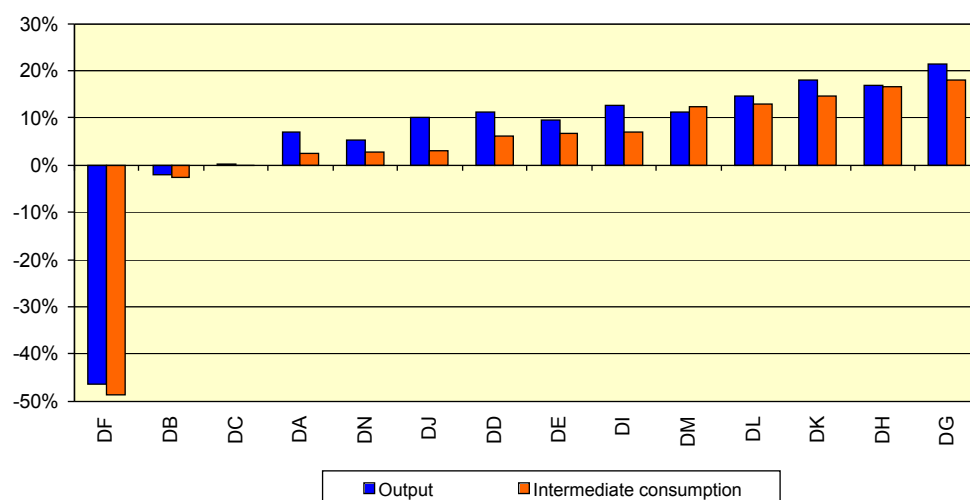
Figure II.2.2 Output including business margin to the subsections of the manufacturing industry



Source: Czech Statistical Office, MIT chart

Only the manufacturing industry showed a faster growth in the output than in intermediate consumption in 2007. The year-on-year ratio between the performance and intermediate consumption is shown in the Figure No II.2.3. The year-on-year lower growth in power consumption was affected by a slight decrease in import prices by 1 %. In terms of import prices the first three quarters of 2007 were mainly characterized by a significant year-on-year decline in import prices of fuels. Their prices, however, in the fourth quarter, despite a significant strengthening of the CZK increased significantly. The branches with an above-average growth of the book value added showed a more significant performance growth advance before the intermediate consumption.

Figure II.2.3 The year-on-year relation between the output and intermediate consumption (in current prices)



Source: the Czech Statistical Office, MIT Chart

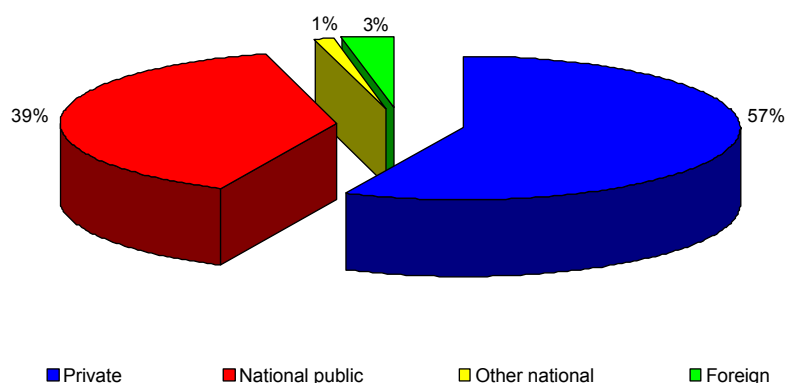
Labour productivity grew in the course of employment growth in the manufacturing industry

A **labour productivity** of the book value added (in current prices) in the industry the year grew year-on-year by 9.1 % (4.8 % in real terms - according to the model calculation), most in the manufacturing industry (see Table II.2.1) in the course of the increase in employment (other sections showed again decrease - see the Table II.2.1).

A high growth in spending on research and development with the dominance of private sources of funding

Research and development and innovation activities are considered for a **key area for the development of the economy**, growth of its competitiveness and balanced regional development, including efforts to a qualitative change in the economy from the assembly one to a knowledge-based economy. According to the latest available figures for the year 2006, the total expenditure on research and development in the Czech Republic year-on-year increased by 18.3 % (by 88.4 % when compared to the year 2000), their share of the GDP reached 1.55 % (the average of the OECD countries: 2.3 %, furthermore 1.7 % for the EU-25, 1.9 % for the EU-15 and 0.8 % for the new member countries (EU-10), out of which 0.88 % are funded from the business sources, 0.6 % from the public resources and a small part financed from foreign sources.

Figure II.2.5 Expenditure on research and development according to sources of financing

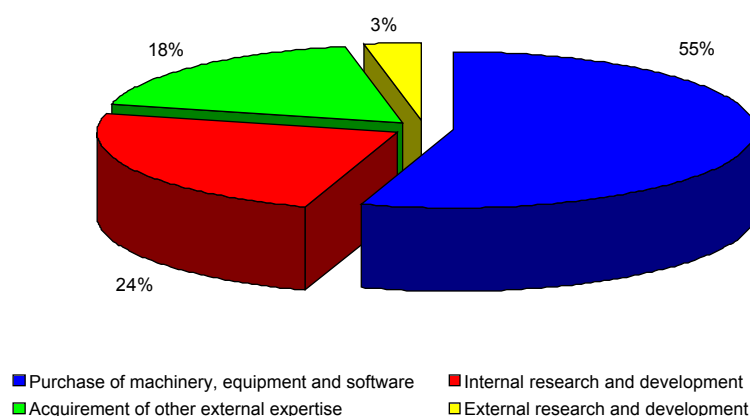


Source: Czech Statistical Office, chart MIT

The business sector was dominant in terms of total spending on research and development with a market share of 66.2 %, as for other sectors; the government sector participated with 17.5 %, universities with 15.9 % and non-profit sector with 0.4 %.

As regards the innovation costs, expenditure on machinery, equipment and software played a decisive role

In the field of **innovation activities** broken down by the cost structure in 2006, the largest portion of funds directed towards the purchase of machinery, equipment and software (chart No. II.2.6.). From the point of view of the size of individual companies, large enterprises had the highest costs in 2006, which amounted to the two-thirds the total costs. As for the medium-sized and small enterprises, limiting factors were more apparent, during which time a main obstacle was the lack of funds, furthermore the lack of skilled workers (small businesses can not afford to overpay experts), lack of market information and difficult search for a partner.

Figure II.2.6 Costs structure for the innovations

Source: Czech Statistical Office, MIT chart

In addition to its own costs, the businesses could obtain a support for innovative activities from the public sources in 2006, where the government was a dominant provider, the aid of which was tapped by 60 % of businesses. Among the other providers, it is necessary to make a mention of the EU, from a support of which benefited about 40 % of the businesses and the existence of the 5th and 6 Framework Programme from a support of which benefited 20 % of the businesses. A support from the local or regional offices was received by 18 % of businesses.

An importance of the high-tech sector gradually grew up

The sophisticated technology production with a high value added is one of the cornerstones of a prosperous economy. The high-tech sector involves the economic activities⁵ using the advanced technology in a large extent. The receipts from sales in the high-tech sector in the manufacturing industry in 2006 took a share of 12.2 % (increase of 3.2 p.p. when compared to the year 2002), and 8.4 % in the employment. This indicates a high level of productivity in the sector. The structure of high-tech sector shows the largest share of NACE 30 and 32 - together 76.5 % (increase of 6.6 p.p. when compared to the year 2002). Up to a certain extent, this sector is based on imported technology and knowledge (firms under foreign control) and is of the assembly nature.

⁵ According to the OECD methodology:

NACE 244 - production of pharmaceuticals, chemicals, herbal preparations and other means for medical purposes

NACE 30 - Production of office machinery and computers

NACE 32 - production of radio, television and communication equipment and apparatus

NACE 33 - Production of medical, precision and optical instruments, watches and clocks

NACE 353 - production and repairs of aircrafts and spacecrafts

III. CONSTRUCTION

III.1. Production, employment and productivity

Construction output retained the pace of growth...

The Construction was dynamically developing for already eighth years. In 2007, the **building operations** reached, as a whole, a **solid year-on-year growth** of 6.7 % (in 2006 amounted to 6.6 %).

... thanks to the building construction...

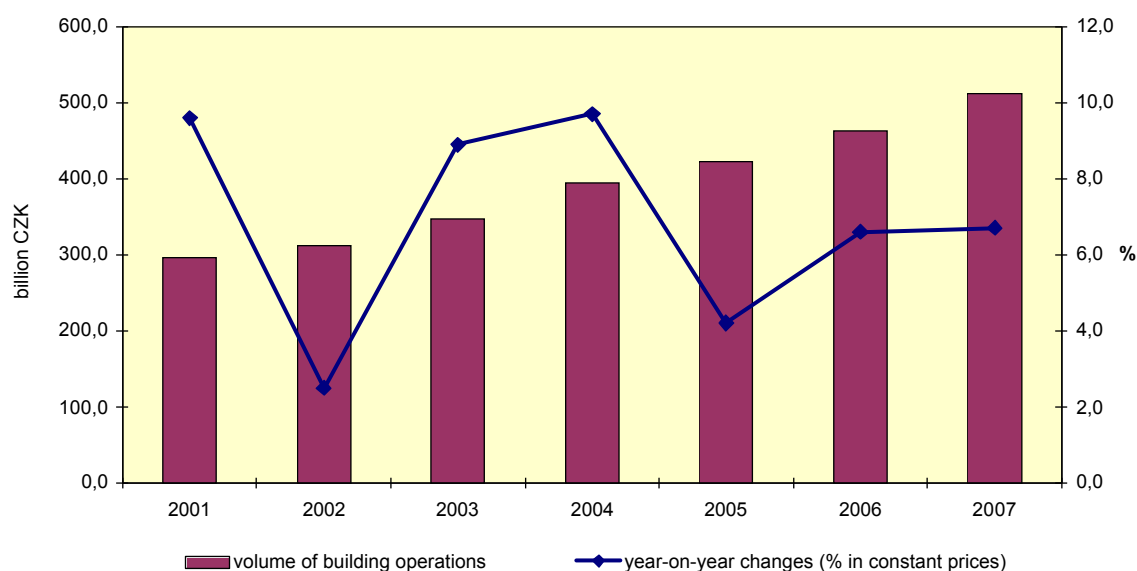
The continued implementation of development projects of foreign investors focused mainly on the construction of factory buildings, administrative and multi-functional centres and ongoing intensive housing resulted in a high growth in the building construction (by 9.7 % for organizations with 20 employees or more).

... and thanks the growth upturn in the civil engineering in the course of the 4th quarter of 2007

On the other hand, delays in preparation and financing of new civil engineering works and a high comparative base resulted in the year-on-year decline of the engineering construction (by 2.6 % for organizations with 20 employees or more), which, after the release of funds for the transport infrastructure at the end of the year, gained again growth momentum.

Development of construction output in the years 2001 to 2007 is shown in the chart No. III.1.1.

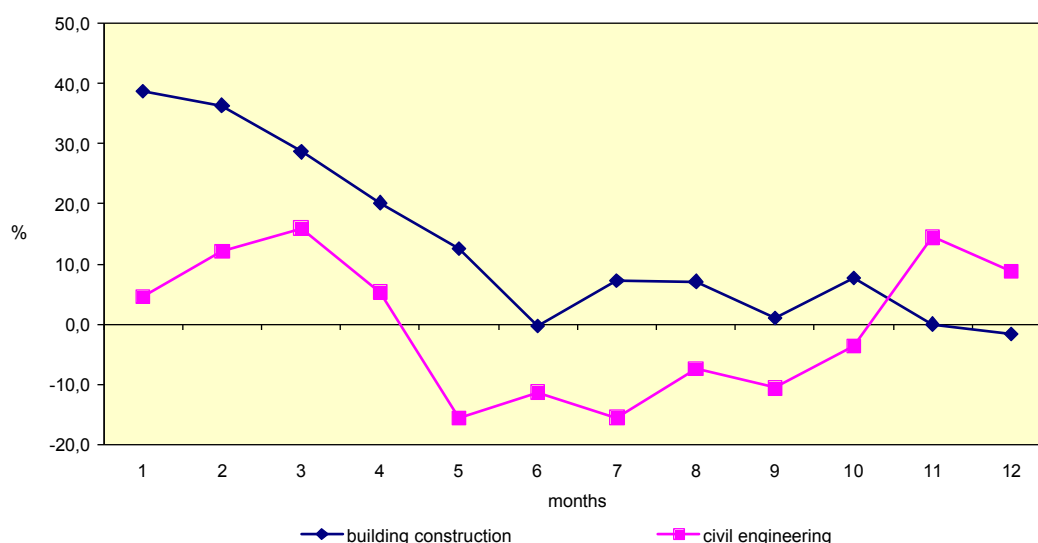
Figure III.1.1 Construction output in the years 2001 to 2007 (year-on-year changes in %)



Source: The Czech Statistical Office, MIT Chart

Development of the building construction and civil engineering in 2007 is depicted in the Figure No. III.1.2.

Figure III.1.2 Development of the building construction and civil engineering in 2007
(year-on-year changes in %)



Source: Czech Statistical Office, MIT Chart

Construction output in small businesses grew faster...

Small firms (up to 19 employees) speeded up the growth of building operations (from 6.7 % in 2006) to **8.6 %**. Their proportion in the total volume of construction work involved 31.3 % and geared primarily on the repair and maintenance of dwelling stock. They also acted as subcontractors of large construction companies.

Table III.1.1 The structure of building operations in the years 2002-2007
(construction companies with 20 employees or more)

	Year-on-year change in %					2007		
	2002	2003	2004	2005	2006	Y-o-y change in % const.prices	volume (in mill. CZK, curr.prices.)	share (in %)
Construction work in total								
under supply contracts	2,6	9,0	8,9	5,1	6,6	5,8	350 840	100,0
out of which								
- domestic in total	3,5	9,2	8,4	4,8	5,3	4,4	338 522	96,5
new construction, reconstruction and renewal	1,8	8,3	10,0	6,5	6,0	5,7	299 057	85,2
of which: building construction	-2,6	6,9	51,6	2,2	9,0	10,9	189 668	54,1
civil engineering	10,3	10,7	32,8	13,3	1,6	-2,4	109 389	31,1
repairs and maintenance	14,1	14,7	-1,3	-5,8	6,3	-2,8	38 147	10,9
of which: building construction	8,3	6,0	6,9	-2,0	-11,0	-1,8	18 092	5,2
civil engineering	22,5	25,3	6,1	-10,2	28,6	-3,7	20 055	5,7
other construction work	19,6	5,4	18,0	6,0	-48,2	-37,2	1 318	0,4
- abroad	-35,3	-1,4	49,5	17,9	73,7	51,6	12 318	3,5

Source: CZSO

... more than in larger companies

The total volume of **construction work in large companies (with 20 or more employees)**, which provided 68.7 % of the construction works, **grew** by 5.8 % on

the year-on-year base (in the same period of the previous year by 6.6 %). The growth of domestic construction output (by 4.4 %) was achieved thanks to a new construction, reconstruction and building renewal. All other categories of construction work in the Czech Republic declined.

As to the new construction, reconstruction and building renewal, only building construction grew

A decisive volume of the construction work of these firms in the Czech Republic was **conducted in new construction, reconstruction and building renewal** (with the year-on-year **growth of 5.7 %**) and dominated by the building construction with the year-on-year increases of 10.9 %. In spite of the year-on-year decline in the production of the civil engineering by 2.4 % (including delays in the preparation of new projects in the civil engineering works, or due to the lack of certain professions), it is necessary to bring forward a highly positive trend of the last months in 2007 when the civil engineering, after the release of funds for transport infrastructure, accelerated and quickly caught up the six-month declines.

Repair and maintenance experienced decline

Maintenance and repair decreased year-on-year by 2.8 %, while the decline in engineering construction was 3.7 % and the building construction dropped by 1.8 %.

Export of construction works rose

The construction works abroad achieved the year-on-year growth of 51.6 % due to a low comparative base. Their proportion (3.5 %) in the total volume of the building operations proves the essential focus of the construction on the domestic market.

Table III.1.2 Wages, labour productivity and unit labour costs
(organization with 20 employees or more, year-on-year % difference)

	Line	2000	2001	2002	2003	2004	2005	2006	2007
Average nominal wage	1	4,9	7	6,4	6,1	6,2	3,8	7,3	7,9
Average real wage*	2	0,9	2,8	3,7	3,9	2,8	0,8	4,3	3,8
Labour productivity from construction (in constant prices.)	3	10,8	8,5	0,7	7,8	5,3	0,2	6,3	7,5
Labour productivity from basic building construction (in constant prices)	4	7,6	1,1	-1,0	6,6	2,4	6,3	6,3	7,4
Nominal wage cost units	1/3	-5,3	-1,4	5,7	-1,6	0,9	3,6	0,9	0,4
Real wage cost units	2/3	-8,9	-5,3	3,0	-3,6	-2,4	0,6	-1,9	-3,4

*average nominal wage converted by building work index

Source: CZSO

The growth in average nominal wages outpaced the labour productivity growth

Employment in the construction enterprises with 20 employees or more decreased year-on-year by 1.5 % to 159.6 thousands of people. A **growth in labour productivity** of the construction works under the supply contracts (S) by **7.5 %** (in constant prices) at even faster growth in **average nominal wages** by 7.9 % (real wages increased by 3.8 %) led to a slight increase in the **nominal unit labour costs** by 0.4 %, in real terms, however, decreased by 3.4 % (see Table III.1.2).

Similar results were shown by the indicator of labour productivity from the basic building operations⁶ with the year-on-year growth of 7.4 %.

⁶ Indicator "The basic building production - increased by 5.7% year-on-year – it does not include construction work performed for the companies by way of subcontracting, and therefore more accurately reflects the performance.

Table III.1.3 Basic indicators of the construction enterprises according to the institutional sector and size in 2007

Indicator	Number of enterprises	Construction work under the supply contracts			Average number of employees			The average nominal wage		Labour productivity (S)	
		total in mill. CZK (curr.prices)	Y-o-y changes (%; co.pr.)	share in %	persons (in thous.)	Y-o-y changes (%)	share in %	CZK	Y-o-y changes (%)	thous-CZK curr.pr.)	meziroční změny (%; v s.c.)
Construction companies with 20 employees or more in total thereof by sectors:	2 442	350 840	5,8	100,0	159,7	-1,5	100,0	21 914	7,9	2198	7,5
11001 - Public	7	3 373	95,6	1,0	0,7	10,1	0,4	26 363	4,3	4583	77,6
11002 - National private	2 146	281 451	6,0	80,2	134,9	-2,1	84,5	21 233	8,2	2087	8,3
11003 - private under foreign control	132	61 364	3,7	17,5	19,3	6,2	12,1	28 146	3,3	3180	-2,4
14000 - employers*/	158	4 652	-7,8	1,3	4,8	-14,3	3,0	15 255	10,2	979	7,6
thereof by number of employees											
20-24	625	19 656	18,7	5,6	13,6	-0,1	8,5	16 848	7,3	1443	18,8
25-49	1 057	52 839	6,4	15,1	35,6	-3,1	22,3	17 957	8,4	1485	9,9
50-74	329	30 221	1,5	8,6	19,7	-5,4	12,3	19 254	8,9	1531	7,3
75-99	143	21 636	20,7	6,2	12,2	1,6	7,6	19 797	8,3	1779	18,9
100-199	190	47 085	9,6	13,4	25,2	2,3	15,8	21 144	10,9	1870	7,1
200-299	45	24 472	-7,8	7,0	10,7	-8,9	6,7	21 411	4,8	2299	1,2
300-399	16	13 175	33,1	3,7	5,4	-12,4	3,4	23 685	10,1	2422	51,8
400-499	12	13 191	20,6	3,7	5,3	22,9	3,3	23 824	8,6	2494	-1,9
500-999	16	28 029	-13,7	8,0	11,3	-9,5	7,1	27 087	7,0	2485	-4,6
1000 a vice	10	100 535	6,1	28,7	20,7	5,3	13,0	33 256	3,7	4856	0,8

*) individuals not registered in the Business Register with the number of employees 20 or more

Source: CZSO

Private national firms were most involved in the total volume of construction work

As for the **breakdown of enterprises by institutional sector** (see the Table III.1.3) the national private companies produced majority (80.2 %) of the construction works and were involved in the most important way (84.5 %) in employment in the construction, even if the number of their employees, compared to the same period the previous year, decreased (2.1 %). Under the year-on-year increase in production of 6.0 % the labour productivity rose by 8.3 % while the dynamics of the average nominal wage growth (8.2 %) was almost same.

Companies under foreign control remained the most productive

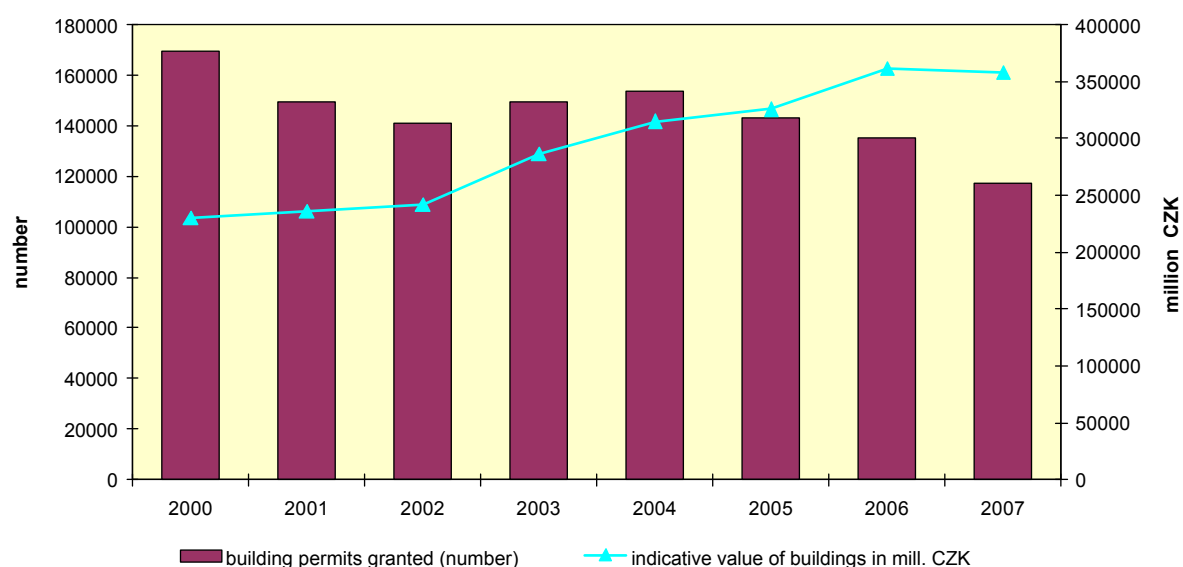
The building operations in private **enterprises under foreign control** (with a share of 17.5 % of the total volume of construction works) increased year-on-year (by 3.7 %), while simultaneously a number of employees rose (by 6.2 %) and their labour productivity decreased (S) by 2.4 %. Companies under foreign control, however, still maintain their high level of lead in labour productivity (S) prior to the national firms, which is by almost 53 % higher, which also results in the level of average wages, that, in the case of foreign companies, reached CZK 28 146 with the year-on-year growth of 3.3 %, compared to CZK 21 233 for domestic firms with the year-on-year growth of 8.2 %.

The production of large construction companies was most significant

In the size structure of the building organizations, companies with 1 000 or more employees with a market share of 28.7 % in building production and 13.0 % in employment played a dominant role.

The highest dynamics of construction work and labour productivity growth was shown by the companies with 300 -- 399 employees. The table III.1.3 is clear upward level of labour productivity, depending on the size of the company. Accordingly, an upward in the level of average monthly wages is also apparent.

Figure III.1.3 Building permits and indicative value of buildings



Source: CZSO, MIT chart

A number of building permits decreased

A number of granted building permits decreased year-on-year by 13.3 % to 117 384, the indicative value of permitted construction dropped by 0.9 % to 357.7 billion CZK. The average value of one building permit increased by 14.3 % to 3 047 thousands CZK, which means, in addition to the price growth, an increased intensity of the average building construction.

In terms of the structure of building permits, in total 47 298 permits were granted for the construction of residential buildings (with the year-on-year decrease of 5.0 %), 20 578 for non-residential buildings (with a decline of 16.0 %), 19 079 and for the construction of buildings for environmental protection (with a decrease of 26.0 %) and the construction of other buildings 30 429 (with a decrease of 13.9 %). The indicative value of construction permitted for new building operations increased for the non-residential buildings by 18.6 % (due to financially costly renewal and reconstruction, especially in the energy field) and for residential buildings by 6.1 %. In 2007 a construction was allowed for 24 buildings with the indicative value of more than 1 billion CZK. For the most part, the construction of transport infrastructure is involved.

III.2. Housing Construction

Flats finishing dominated

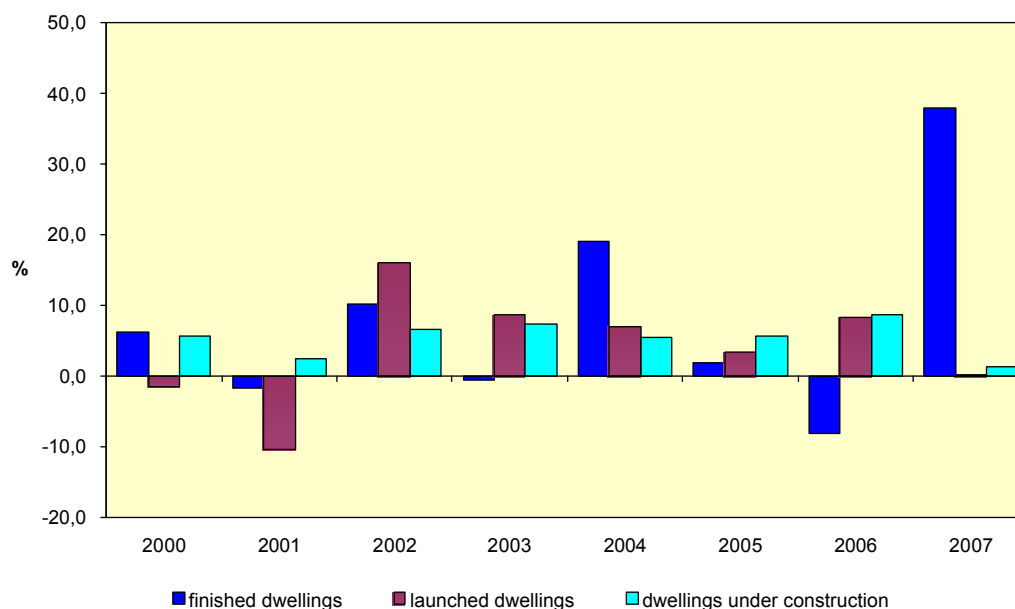
The housing construction in 2007 was distinctive by a **stagnation of started dwellings** that was **accompanied by a record-breaking increase of completed dwellings**, which revealed a declining growth dynamics in the volume of buildings under construction (see Figure No. III.2.1).

The growth dynamics of housing construction was affected by the long-term factors, such as the continuing favourable market situation, mortgages, a developed market for building savings associated with the growth in the number and volume of loans for housing, but also by the change of the VAT on construction work in the housing construction as of January 1, 2008.

The construction of dwellings in the category of family and apartment houses was launched

The construction of **43 796 dwellings was launched in 2007**. In comparison with the same period of the previous year, when an increase of 8.3 % was shown, there was the year-on-year stagnation (+0.1 %).

Figure III.2.1 Dwelling construction in the years 2000 to 2007 (year-on-year change in %)



Source: Czech Statistical Office, MIT chart

A record-breaking growth of completed dwellings

A number of completed dwellings increased year-on-year by 38.0 % to 41 650, which was the best result since 1991.

Long-term growth in the volume of buildings under construction slowed down

The total number of 170 971 Dwellings⁷ in terms of the buildings under construction as of December 31, 2007 slowed down the year-on-year momentum of growth to 1.3 % (+2 146), while in the same period of the previous year grew by 8.8 %.

III.3. Financial situation in the construction

The financial results maintained high growth rates

The **financial indicators** of construction enterprises reached the year-on-year **high growth rates**. This positive development was mainly affected by the above-average building operations of the first quarter of 2007. A significant slowdown in the growth dynamics, on the contrary, in the second half of the year, because of the lack of some construction materials, impacted negatively on the financial results.

⁷ Since January 1, 2006 the calculation of Dwellings under construction is made as a sum of Dwellings under construction at the end of the the previous year and started dwellings in the follow-up period, from which the number of flats which were completed in the follow-up period is being subtracted.

The financial results of **flow indicators** are available for organizations with **50 or more employees**, which occupy the majority in the total construction output. Their year-on-year development is shown in the Table III.3.1.

Table III.3.1 Flow financial indicators and labour productivity in the building industry
(in organization with 50 more employees)

Output including business margin		Intermediate consumption		Book value added		Labour productivity of Value added		Employment
bill. CZK	year-on-year change in % (current prices.)	bill. Kč	year-on-year change in % (current prices.)	bill. CZK	year-on-year change in % (current prices.)	per employee in thousands CZK	year-on-year change in % (current prices.)	year-on-year change
383,4	8,4	309,2	7,6	74,2	12,2	669,5	14,3	-1,9

Source: Czech Statistical Office, calculations MIT

A high growth in labour productivity

In addition to a high demand for building operations, an increase in the price for construction works by 3.9 % also resulted in the **output growth**, including the business margin, and, in particular, receipts from sales of own production (which constitutes 98 % of the total performance). The increased book intermediate consumption was influenced, in return, by the price increase of raw materials and some services, especially in the freight transport. The output, however, grew faster than the book intermediate consumption, which was resulted in a **high growth of the value added**. The decline of employment by 1.5 % contributed to the labour productivity growth from the book value added.

IV. FOREIGN TRADE

IV.1. Summary results

The growth of the economy and its openness led foreign trade to record-breaking results

A coherence between the long-term economic growth and continued competitiveness of the production resulted in the results of foreign trade exchange. In 2007 they were the most successful in the modern history. The Czech Republic, as the only one of the new EU countries, succeeded to export more than import and was able to double this surplus on the year-on-year base. A growth trend in the openness of the economy continued **as evidenced by the high proportion of the value of exports of goods in the Gross Domestic Product**. The export value represented 69.5 % and the value of imports 67.1 %, the year-on-year improvements represented 3.1 p.p. for exports and 2.8 p.p. for imports. A growth of these shares in the past five years (see Table IV.1.1) documented the openness of the economy. A level of **openness of the Czech economy** reached 68.3 %, which is by 6.6 p.p. more against 2004. This illustrates a positive impact of our entry into the EU and the importance of foreign trade for the development of the economy. The Czech economy became one of the most open in the EU.

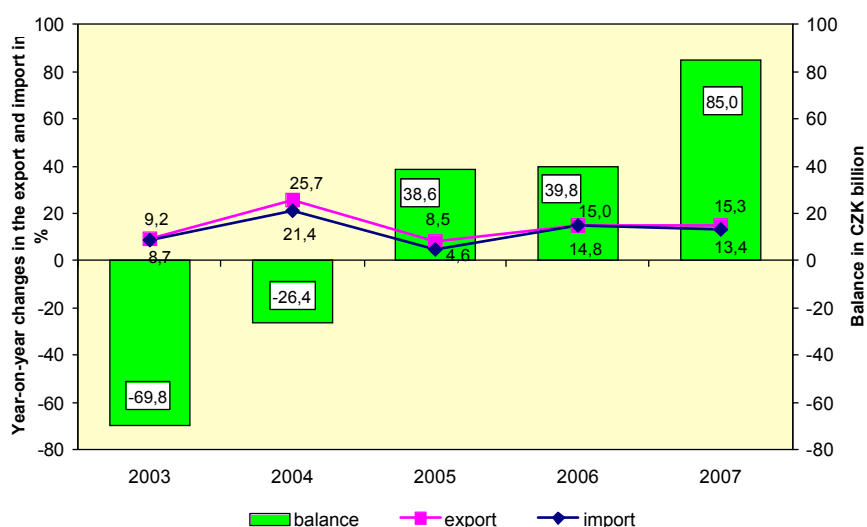
Table IV.1.1 Share of exports and imports of foreign trade in the GDP in the years 2002 - 2007

	2002	2003	2004	2005	2006	2007
Exports in % GDP in current prices	50,9	53,2	61,2	62,5	66,4	69,5
Imports in % GDP in current prices	53,8	55,9	61,7	60,6	64,3	67,1
Rate of openness in %	52,4	54,6	61,7	61,9	65,7	68,3

Source: CZSO

The overall results of the balance of trade prove unambiguously positive developments in the recent years. The balances and the growth rates of exports and imports are shown in the Chart No. IV.1.1.

Figure IV.1.1 Development of foreign trade in the years 2003-2007
(year-on-year changes in the export and import in %, the balance in CZK billion)



Source: Czech Statistical Office, MIT chart

The resulting balance of 2007 was positively influenced by the following factors:

- **effects resulting from the influx of foreign direct investment, especially the continued growth of industrial production** (by 8.2 %), particularly in the manufacturing industry (by 8.9 %). In addition to cars, the production and export of computer and telecommunications technology was also extending;
- **economy growth in the EU countries**, which was involved by 78.2 % in the turnover of the Czech Republic. A growth in **Germany** of 2.5 % is particularly significant, because more than 30 % of Czech exports are directed on the German market. In particular, the neighbouring Slovak economy, where more and more goods is being exported, has rapidly been growing;
- **the terms of trade**, which reached an average of 102.3 for the entire year, while export prices rose by 1.3 % and import fell by 1 %.

Negative impact on the results of foreign trade was caused by:

- **further deepening** of the already **high deficit** with **China** (by 52.2 billion CZK to 171.3 billion CZK) and **Japan** (by 13 billion CZK to 67.5 billion CZK), where we increasingly import not only the engineering and consumer goods, but also market products;
- **persistent deficit with Russia** in the amount of 54.7 billion CZK, although decreased by 28.9 billion CZK on the year-on-year base, especially when, due to the influence of a strong CZK import prices of mineral fuels fell.

The strengthening Czech crown was an important element in the development of foreign trade, which strengthened on average for the year by 10.2 % to the USD and by 2 % EUR. This movement, on the one hand, positively affected on imports, but disadvantaged exports. Rate development also resulted in the quantification of growth dynamics of exports and imports denominated in U.S. dollars or EUR, which was higher than in Czech crowns.

The foreign trade turnover ended with a surplus for the third year in a row

The turnover reached in 2007 amounted to 4 859.7 billion CZK, out of which exports amounted to CZK 2 472.4 billion and imports CZK 2 387.4 billion. The year-on-year growth of the turnover by CZK 610.4 billion showed the prevailing influence of exports, which rose year-on-year by 15.3 % at current prices (imports by 13.4 %) A pace of growth of exports and imports exceeded 15 % in the first three quarters; the slowdown was only in the 4th quarter. Results for all the quarters showed advance in exports for the first time in history. The trade **balance climbed up to 85 billion CZK**, achieving the positive values for the third time in a row (first time in 2005 - 38.6 billion CZK, second time in 2006 - 39.8 billion CZK). The surplus reached two-digit values in all quarters. (see the Table IV.1.2).

Table IV.1.2 Development of foreign trade broken down by quarters of 2007

	1.Q.	2.Q.	3.Q.	4.Q.	1.- 4.Q.2007
Export (in %) in current prices	17,6	16,7	16,6	10,9	15,3
Import (in %) in current prices	15,5	15,0	15,2	8,8	13,4
Balance in 2006 (in bill. CZK)	23,9	7,8	2,9	5,2	39,8
Balance in 2007 (in bill. CZK)	38,1	18,2	10,8	17,9	85,0
Year-on-year change of balance	14,2	10,4	7,9	12,7	45,2
Export (in %) in constant prices	15,8	14,3	14,9	12,6	14,3
Import (in %) in constant prices	17,5	15,5	15,9	11,2	14,9

Source: CZSO

The average export per capita is increasing

In terms of global competition, the **Czech Republic managed to increase the share of exports in the total global exports**. It doubled over the course of the last twelve years, reaching 0.8 %. In doing so, the Czech Republic takes a share of only 0.2 % in the world population. The **value of exports per capita exceedingly grows**. In 2007 it reached USD 11.8 thousands, which was the year-on-year growth of 26.9 %. Compared to 1993, exports per capita increased almost six times.

Enhancement in the coverage of high Export/import trade surplus

A high surplus in the trade balance can be expressed as a relative **export/import overlap**. In 2007, the export- import trade coverage reached 103.6 %, which is an improvement of 8.4 p.p. for the last five years. This coverage is, however, strongly differentiated between the individual commodities (see the Table IV.1.3).

Table IV.1.3 Exports / Imports Coverage for selected commodity groups (in %)

	2003	2004	2005	2006	2007
In total	95,2	98,5	102,1	101,9	103,6
1 food and live animals	63,8	65,7	74,8	69,6	70,9
2 crude materials, inedible, except fuels	93,8	89,4	91,9	95,9	116,1
3 mineral fuels, lubricants and related materials	36,6	40,9	34,2	30,8	35,4
5 Chemicals and related products.	49,0	53,4	59,1	59,3	58,2
6 market manufactured goods classified chiefly by material	109,2	107,7	108,6	103,9	100,9
7 machinery and transport equipment	111,5	118,4	128,8	131,1	130,4
8 industrial consumer goods	105,8	104,1	107,8	106,5	108,0

Source: CZSO

The best export/import coverage was shown by the engineering group (to 130.4 %), although decreased slightly on the year-on-year base. Raw materials improved the export/import coverage by 20.2 p.p.

The amount of the trade balance was influenced by the engineering group...

Machinery and transport equipment strengthened a dominant position, their share in total exports reached 54.2 %. In terms of the engineering exports, the **road vehicles**, the surplus of which strengthened by about a tenth and exceeded 200 billion CZK, lead the list. The overall result of the foreign trade was most burdened, in terms of the commodity, with a high trade deficit in the mineral fuels (although year-on-year decreased by 15 bill. to 124 bill. CZK) and chemicals (where deepened by CZK 14.7 billion to CZK 103.8 billion).

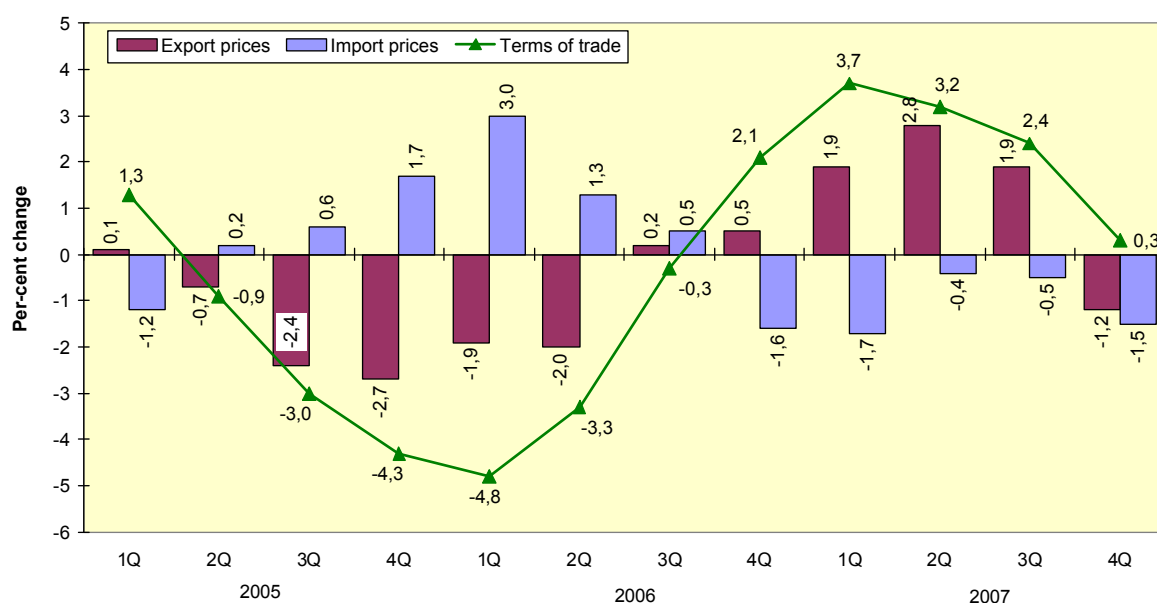
... and successful results in the EU markets

A positive trade balance with the EU countries reached 414.7 billion CZK and allowed to **overlap the high deficits** arising from trade with the rest of the world, especially the **high deficit with China**, which further deepened (by about a half p.a.) to 171.3 billion CZK. The trade balance with the EU countries has been continuously growing, increased by 64.9 billion CZ and, by 17 times against the year 2000. The influence of individual countries on the development of balance is quantified in the chapter on the territorial structure.

Positive developments in terms of trade

As a result of growth in the export prices by 1.3 % and decline in the import prices by 1 % the terms of trade reached in average the positive value of 102.3 for the entire year, representing the year-on-year improvement of 3.8 points. The Figure IV.1.2 shows the quarterly developments of the terms of trade in the years 2005 to 2007 and indicates the weakening of positive effects in the 2nd half of the year.

Figure IV.1.2 Quarterly changes in prices in foreign trade in the period 2005 - 2007



Source: Czech Statistical Office, chart MIT

Table IV.1.4 presents the reflection of changes in prices in individual commodity groups.

Table IV.1.4 Terms of Trade (as per Price Indexes)

SITC groups	Export price Index			Import Price Index			Terms of Trade		
	2005	2006	2007	2005	2006	2007	2005	2006	2007
Total	98,6	98,8	101,3	100,3	100,3	99,0	98,3	98,5	102,3
0 Food	96,9	99,2	112,2	99,2	99,2	102,8	97,7	100,0	109,1
1 Beverages and tobacco	105,8	94,1	101,2	100,5	94,5	99,8	105,3	99,6	101,4
2 Raw materials	98,0	112,4	112,6	101,1	93,7	107,1	96,9	120,0	105,1
3 Mineral fuels	116,5	105,8	106,3	129,2	112,6	98,7	90,2	94,0	107,7
4 Fats	94,4	99,6	111,8	89,3	94,5	114,4	105,7	105,4	97,7
5 Chemicals	101,4	99,6	101,0	98,1	98,4	100,9	103,4	101,2	100,1
6 Market products classified	99,3	98,2	103,7	99,1	104,2	102,0	100,2	94,2	101,7
7 Machinery and transport equipment	96,0	98,2	99,2	96,0	98,1	96,3	100,0	100,1	103,0
8 Industrial consumer goods	97,5	97,4	99,2	92,7	93,9	97,0	105,2	103,7	102,3

Source: Czech Statistical Office

**Prices facilitated
the resulting trade
balance**

Price developments, against the previous year, had a positive impact on the trade balance, prices contributed to the amount of the balance in the range of 51 billion CZK (i.e. that after its exclusion the overall surplus would be only 34 billion CZK). In constant prices (i.e. in tangible terms) the import was, on the contrary, in advance prior to export, in contrast to the current prices. Exports in the tangible terms increased by 14.3 % and imports by 14.9 % p.a.

**The dynamics is
higher both in the
dollar and EURO
terms**

The value results in the crown terms were influenced by the year-on-year strengthening of the CZK, both against the dollar and EURO (by 10.2 %, respectively by 2 %). Therefore, the dynamics of exports and imports in the U.S. dollars terms were significantly higher than in crowns (exports increased by

28.7 %, imports by 26.6 % in dollars). In terms of the EURO, the pace of exports and imports was only slightly higher than in the crowns (17.8 % and 15.9 % respectively). Exports reached 122.4 billion USD (EURO 89.1 billion) and imports 118.3 billion USD (EURO 86.1 billion). A positive trade balance amounted to 4.1 billion USD, i.e. 3.1 billion EURO; the year-on-year improvement amounted to \$ 2.4 billion and EURO 1.7 billion.⁸

IV.2. Territorial Structure

The highest increase both in exports and imports from advanced economies

The advanced market economies participated by 86 % in the increase of exports (327.8 billion CZK), although their year-on-year share weakened slightly (by 0.7 p.p. to 91.1 %). Exports rose to all territorial groupings. The exports to other so-called non-European countries increased by more than a half, by 26 % to the Commonwealth of Independent States, by 21.5 % to developing countries and by 18.8 % to the European transition economies. The total share of exports to these four areas constitutes neither the tenth of the total exports.

Imports from all territorial groups with the exception of the Commonwealth of Independent States also rose (compared to the previous year was lower by 10.2 % due to a decline in import prices of mineral fuels). The highest increase in imports accounted for the advanced market economies (220.9 billion CZK) valued at more than three-quarters of the total increase. Due to a robust growth in imports from China, we reached the highest dynamics in imports from outside Europe (by 44.2 %). Detailed figures on turnover, exports, imports and the balance in the territorial breakdown are listed in the Annex Table IV.1.

The surplus in balance of trade with the EU increased by one-fifth p.a.

The trade of exchange with EU countries, which in 2007 accounted for almost 78.2 % of the total turnover, developed successfully. The surplus generated in trade with the EU (414.7 billion CZK) covered high deficits with the countries outside Europe (173.6 billion CZK), CIS (63.3 billion CZK) and developing economies (52.7 billion CZK). The overview of countries with the largest balance of trade surpluses, ranked descending is shown in the Table IV.2.1.

Table IV.2.1 Countries with the largest balance of trade surplus in 2007

County	Achieved surplus in bill. CZK	Y-o-y change in bill. CZK	The highest surplus in commodity groupings (SITC), involved in the overall deficit of the country in bill. CZK							
CR in total	85,0	45,2	machinery and transport equipment	312,5	industrial consumer goods	19,4	raw materials	9,1	market products	4,3
Germany	91,2	5,6	machinery and transport equipment	106,7	industrial consumer goods	28,5	raw materials	15,1	mineral fuels	1,0
Slovakia	88,6	21,0	machinery and transport equipment	46,6	industrial consumer goods	13,6	food	10,4	chemicals	8,9
United Kingdom	58,7	11,3	machinery and transport equipment	52,9	industrial consumer goods	6,2	market products	5,5	food	0,7
Austria	24,0	-7,0	machinery and transport equipment	21,2	raw materials	7,8	industrial consumer goods	4,7	mineral fuels	1,1
France	23,4	5,3	machinery and transport equipment	36,3	industrial consumer goods	4,2	raw materials	0,5		
Belgium	23,1	3,5	machinery and transport equipment	32,7	industrial consumer goods	7,0				
Romania	20,8	5,4	machinery and transport equipment	11,1	market products	3,6	chemicals	2,5	industrial consumer goods	1,6
Spain	18,1	0,7	machinery and transport equipment	22,5	industrial consumer goods	3,4	market products	0,8	raw materials	0,6
Sweden	16,0	3,9	machinery and transport equipment	19,3	industrial consumer goods	2,8	beverages and tobacco	0,3	food	0,2
Poland	10,9	8,4	machinery and transport equipment	20,8	chemicals	2,6	market products	1,8	raw materials	1,2

Source: CZSO

The most significant positive changes

Countries with the most significant improvements in trade results:

- The deficit fell most with **Russia** out of all countries, namely by 28.9 billion CZK to 54.7 billion CZK. The decrease in the deficit was mainly influenced

⁸ Conversions of values into the USD and EURO are used in international comparisons.

by the mineral fuels by reducing liabilities for, in particular, oil and petroleum products, and machinery and transport equipment by a growth in assets of mainly road vehicles and machinery generally used in the industry.

- The surplus with **Slovakia** rose by 21 billion to CZK 88.6 billion, which is close to Germany, with which we have the highest long-term positive balance. A better result resulted mainly from the growth of exports of market products, machinery and transport equipment, but also food.
- The trade of exchange with the **United Kingdom** increased the positive balance by 11.3 billion to CZK 58.7 billion. The export of equipment for automatic data manufacturing increased by roughly a third and exports of road vehicles by a tenth.
- In **Norway**, there was an improvement of nearly 8.9 billion CZK when the passive balance of trade by 5 billion CZK turned into the active amounting to 3.9 billion CZK. The growth in exports of 41.9 % was influenced by the increased exports of machinery and transport equipment and the decline in imports was affected by the half as less value of imports of the mineral fuels.
- An active balance with **Poland** (after the downturn in 2006) improved by 8.4 billion to CZK 10.9 billion mainly due to an export growth by 22.2 %, while imports increased by 15.6 %.
- A trade surplus with our largest trading partner, **Germany**, was increased by 5.6 billion to CZK 91.2 billion, when the dynamics of exports and imports were below the standard (11.2 % respectively. 11.9 %) in view of the high level of trade already achieved. Exports of the raw materials increased by more than a quarter. An increase in the positive balance was influenced by the growth of the assets of certain items from the engineering group.

List of commodities, which are involved in these deficits greatest contribution is given in the table IV.2.2.

Table IV.2.2 Countries with the highest balance of trade deficit in 2007

Country	Achieved deficit in bill. CZK	Y-o-y change in bill. CZK	The highest deficits in commodity groupings (SITC), involved in the overall deficit of the country in bill. CZK			
China	-171,3	-52,2	machinery and transport equipment -113,5	industrial consumer goods -38,0	market products -15,0	chemicals -2,8
Japan	-67,5	-13,0	machinery and transport equipment -54,6	market products -6,2	industrial consumer goods -5,8	chemicals -1,2
Russia	-54,7	28,9	mineral fuels -90,3	raw materials -4,9	market products -0,8	
Taiwan	-23,7	0,7	machinery and transport equipment -18,4	industrial consumer goods -3,8	market products -1,3	chemicals -0,1
Azerbaijan	-19,6	1,2	mineral fuels -20,7	raw materials -3,4		
South Korea	-16,6	-3,2	machinery and transport equipment -14,6	market products -1,3	chemicals -0,6	raw materials -0,2
Malaysia	-16,2	-2,7	machinery and transport equipment -14,0	raw materials -1,1	industrial consumer goods -0,8	market products -0,1
Thailand	-14,5	-4,5	machinery and transport equipment -9,7	industrial consumer goods -1,9	market products -1,9	raw materials -0,7
Ireland	-8,0	-5,2	chemicals -3,9	industrial consumer goods -2,5	machinery and transport e -1,1	food -0,6

Source: CZSO

Countries with the largest year-on-year deepening balance of trade deficit in 2007:

- The most significant worsening in trade balance (CZK 52.2 billion) was in trade with **China**, with which we have the highest negative balance of 171.3 billion CZK. The exports covered the imports only from 7.6 %. Imports from China rose year-on-year by more than a half and participated in imports from non-European countries by 97.8 %.

- The second highest deficit and the second largest showed worsening was shown in trade with **Japan**, where the trade deficit deepened year-on-year by 13 billion CZK to 67.5 billion CZK, mainly due to the growth of the value in imports by 21.8 % and stagnation in exports.
- The third, in terms of the year-on-year deterioration, is **Austria**, the surplus of which was reducing in the recent years (in 2004 was a positive balance of 33.6 billion CZK still the third highest). The year-on-year fall in active trade balance by 7 billion CZK to 24 billion CZK was affected by the nearly doubled growth in imports of mineral fuels, especially oil and petroleum products.

IV.3. Commodity Structure

Machinery and transport equipment strengthened their leadership

In terms of the commodity structure a dominant position of the **machinery and transport equipment** (SITC 7) was still strengthening and their **trade surplus rose by 41.5 billion CZK to 312.5 billion CZK**. As a result of the influx of foreign investment and in addition to cars also other production expanded, especially the computer and telecommunications technology (for example the company Foxconn in Pardubice and Bosch in Jihlava and České Budějovice). This facilitated a further strengthening of the proportion in exports of the engineering group (year-on-year by 1 p.p.) to 54.2 % and imports (by 1.6 p.p.) to 43 %. As for the other groups, the mineral fuel trade significantly improved an outcome (by 15 billion Czech crowns) and raw materials (by 11.9 billion CZK). In contrast, the further growth of the deficit occurred in chemicals (13.6 billion CZK) and in the market products, where a reduction in the active balance amounted to 12.4 billion CZK (see Table IV.3.1).

Table IV.3.1 Commodity structure of foreign trade according to SITC in 2007

	Total	0	1	2	3	4	5	6	7	8	9
Export (share in %)	100,0	2,9	0,6	2,6	2,7	0,1	5,8	20,4	54,2	10,6	0,0
Import (share in %)	100,0	4,3	0,7	2,4	8,0	0,1	10,4	20,9	43,0	10,1	0,1
Balance 2006(in bill. CZK)	39,8	-27,0	-2,3	-2,3	-139,0	-2,1	-89,1	16,7	271,0	14,4	-0,4
Balance 2007 (in bill. CZK)	85,0	-29,8	-1,0	9,1	-124,0	-1,3	-103,8	4,3	312,5	19,4	-0,5
Year-on-year difference in balance	45,2	-2,8	1,3	11,4	15,0	0,8	-14,7	-12,4	41,5	5,0	0,0

0 – food
1 – beverages and tobacco
2 – raw materials
3 – mineral fuels
4 – animal and vegetable fats
5 – chemicals

6 –Market products classified mainly by materials (they are mainly leather and leather products, products made of rubber, wood, paper, including paper, textile products, with the exception of clothes, cement, glass, porcelain, ceramics, iron and steel non ferrous metals, and products made of metals)
7 – Machinery and transport equipment
8 –Manufactured consumer goods (they are mainly prefabricated buildings, healthcare and installation and other similar technologies, furniture, haberdashery, clothes, shoes, instruments, weapons, ammunition, sport goods, and toys)
9 –Not classified commodities

Source: CZSO

The trade balance of the largest commodity groups, SITC 7 was affected, in particular, by:

- **Road vehicles** with a surplus of 200.9 billion CZK, while the export grew by 11.8 % and reached 409.2 billion CZK so that took a share of 30 % in the total group exports.

As regards the road vehicles, in particular, passenger cars, parts and accessories for them carry on drive. The share of passenger cars in the total exports weakened by 0.8 p.p. to 8.2 %, imports stagnated at 2.3 %, and trade surplus rose by 4.5 billion CZK to 148.4 billion CZK.

About increased the value of exports of passenger cars to Russia (by more than three-quarters) rose by 2.6 billion CZK, to Germany by 1.8 billion CZK and to Poland and Norway consistently by 0.8 billion CZK. Overview of the twelve largest customers for the passenger cars in 2007 is given in the Table IV.3.2.

Table IV.3.2 The biggest buyers of passenger cars in 2007

Country	Export in bill. CZK	Year-on-year change in %	Share in %
Total	203,6	5,1	
Of which:			
Germany	44,7	4,2	22,0
Italy	17,6	-0,2	8,6
United Kingdom	16,4	4,0	8,1
France	15,0	-5,7	7,4
Poland	9,8	9,2	4,8
Spain	9,7	-2,1	4,8
Slovakia	8,3	-9,8	4,1
Belgium	8,3	-5,3	4,1
Romania	6,8	9,4	3,3
Russia	6,4	71,1	3,1
Hungary	6,0	3,1	2,9
Austria	5,2	-13,1	2,6

Source: Information retrieval system for external trade statistics of the MIT

The share of parts and accessories for the motor vehicles remained unchanged, exports rose by 7 % and imports by 4.3 %. A positive trade balance increased by 9.9 billion CZK to 67.2 billion CZK.

- **Electrical equipment, apparatus and appliances** showed the second largest year-on-year improvement in the group by turning a passive trade balance of 0.6 billion CZK into active of 10.9 billion CZK, while exports growth pace was twice faster than in imports (11.2 % to 5.6 %). The exports of electrical equipment for the start and ignition of the engine increased by more than a third and battery and accumulator cells by roughly a quarter.

Table IV.3.3 Machinery and transport equipment

	Export		Import		Trade balance	
	2007 bill. CZK	Y-o-y change	2007 bill. CZK	Y-o-y change	2007 bill. CZK	Y-o-y change bill. CZK
SITC 7 – total	1 339,8	17,4	1 027,3	18,0	312,5	41,5
71 - machinery and equipment for energy production	74,4	16,5	67,4	7,5	7,0	5,8
72 - machinery for certain industries	78,8	19,3	66,4	22,6	12,4	0,5
73 – metal manufacturing machines	24,8	24,2	22,8	14,5	2,0	1,9
74 - machinery and equipment generally used in industry	169,1	14,7	128,7	16,0	40,4	4,0
75 - office machines and equipment for automatic data manufacturing	181,3	8,8	156,9	15,3	24,4	-6,2
76 - equipment for telecommunications, sound recording and reproduction	140,7	68,1	134,2	57,3	6,5	8,1
77 - electrical equipment, apparatus and appliances	228,5	11,2	217,6	5,6	10,9	11,5
78 - road vehicles	409,2	11,8	208,3	15,7	200,9	15,0
79 - other transport and equipment	33,1	45,0	25,0	60,3	8,1	0,9

Source: CZSO

Surplus in market products dropped year-on-year by a quarter...

The second largest group of commodities, **market products classified chiefly by the material composition** (SITC 6), decreased a surplus from 16.7 billion to EUR 4.3 billion CZK, mainly as a result of the imports growth's ahead position overpacing exports (16.5 % to 13.1 %). A share in exports weakened by 0.4 p.p. to 20.4 %, while the imports rose by 0.5 p.p. to 20.9 %. More detailed figures are indicated in the structure of goods in the Annex Table IV.2.

... conversely, a surplus of industrial consumer goods increased by one third

The third largest commodity group of **industrial consumer goods (SITC 8)** increased the positive trade balance by 5 billion to CZK 19.4 billion CZK. Shares of industrial consumer goods both in the exports and imports slightly weakened by 10.6 % respectively 10.1 %, while the exports increased by 10.7 % and imports by 9.1 %.

The deficit of fuels decreased by one tenth

A decline in the value of imports of mineral fuels (SITC 3) of 4.5 % was affected by the decline in import prices mainly in the first half of the year. The import prices decreased by 9.4 % in the 1st quarter, by 4 % in the 2nd quarter and by 2.6 % in the 3rd quarter. Since September they began to grow and in the 4th quarter of the year they were higher by 12.1 %. The average for the entire year indicated a decrease of 1.3 %.

The price of the Brentd crude oil increased during the year from \$ 54.5 / barrel (in January) to \$ 90.6 / barrel (in December), reaching an average of 72.6 USD / barrel and thus became by 9.7 % higher than in 2006. **The price of gas** rose to USD 340.9 per thousands cubic metres (in December), the average for the year amounted to 307.9 USD/tm3 and the year-on-year increase represented 1.3 %.

Increase in the active balance of electricity

The increase in the active balance of electricity by 2 billion CZK (to EUR 15.7 billion) was affected by the year-on-year growth of exports by 24.8 %.

Chemicals most deepened the deficit

The deficit of chemicals and related products (SITC 5) further deepened the 14.7 billion to CZK 103.8 billion, when the growth rate of imports grew faster than the pace of exports (by 13.4 % respectively by 11.2 %). The export / import coverage is worsened by 1.1 p.p. when the exports covered imports from 58.2 %.

The decrease in exports of sugar affected the increase in food deficit

Food and live animals (SITC 0) is a group, which according to the amount of deficit (29.8 billion CZK), takes the third place in terms of the commodity structure. Both exports and imports increased above average (by 17.1 % to 15 %) and the passive balance increased by 2.8 billion CZK. The exports covered imports from 70.9 % (year-on-year improvement of 1.3 p.p.).

Raw materials turned from the passive trade balance into the active

The raw materials, inedible and except for fuels (SITC 2) were the third commodity from the point of view of improving the year-on-year balance. Exports of raw materials increased by 18.6 %, while imports decreased by 2.1 %. The passive trade balance of 2.3 billion CZK turned into the active one in the amount of 9.1 billion CZK.

The second smallest commodity group, **beverages and tobacco** (SITC 1, less than 1 % share in the turnover), decreased the passive trade balance of 2.3 billion CZK to 1 billion CZK, in particular, thanks to the growth of exports of the tobacco products by 88 %. The smallest group of goods, **animal and vegetable oils, fats and waxes** (SITC 4 involved in both exports and imports with 0,1 %) decreased a negative trade balance of 0.8 billion CZK to 1.4 billion CZK, when exports grew and imports declined at the same time.

Trading the HI-TECH products

The commodity structure of our foreign trade also shows the development of the trade with HI-TECH products, which are characterized by sophisticated technologies. Their share in our total imports after the year 2000, in the long term, fluctuated around the level of roughly 15 %. An increasing technical level of the domestic production corresponds to a long-term increase in the proportion of these products in our total exports. In 2000, ranged from less than 8 %, in the past year, the proportion was higher by more than a half. A negative trade balance of this commodity group declined to a third against the year, amounting to 30 billion CZK in 2007. A major item, representing a half of exports of the HI-TECH products, is computer technology, where we achieved a positive balance of 25 billion CZK in 2007.

Products with a higher degree of manufacturing holds the high shares

The trade structure according to the degree of manufacturing of the production changed only slightly while the growth of both exports and imports was double-digit. The share of exports of products with higher degree of manufacturing decreased slightly to 87.9 %, imports increased by 1.7 p.p. to 80 % (the Table IV.3.7).

Table IV.3.7 Structure of exports and imports according to the degree of manufacturing in 2006 and 2007

	Share in %			
	Export		Import	
	2006	2007	2006	2007
A. Products with lower degree of manufacturing	12,8	12,1	21,7	20,0
- food and foodstuffs	3,6	3,9	5,2	5,2
- raw materials incl. energy materials and secondary waste	2,4	2,4	8,8	7,0
- semi products	5,8	5,8	7,7	7,8
B. Products with a higher degree of manufacturing	88,2	87,9	78,3	80,0
- engineering, mechanical and electrical products	60,0	60,6	46,9	48,5
- other finished products	28,2	27,3	31,4	31,5

Source: MIT

V. INTERNAL TRADE AND FINAL HOUSEHOLD CONSUMPTION

V.1. Trade Sector

**Business activity
in trade is
significant**

The development of business and economic results of the trade sector are related to the overall performance of the economy and its social context. The growth in sales and changes in their structure **results the development of the purchasing power of households, consumer sentiment, purchasing activities of non-residents and other sectors**. Their development initiates downstream business activities, both in domestic production and foreign trade.

The share of 14.7 % of total **employment** makes the trade sector second largest in the national economy. Its share in the gross **value added** was 13.1 %, being the level of the previous year.

The **total year-on-year sales growth** in 2007 is the highest in methodologically comparable time series since 2000.

Table V.1.1 Revenues from trade (current prices excluding VAT)

	Revenues in bill. CZK				Y-o-y growth in %			Share in %		
	2004	2005	2006	2007	05/04	06/05	07/06	2005	2006	2007
Trade sector (G=NACE 50,51,52)	2 587,7	2 750,3	2 913,1	3 173,1	6,3	5,9	8,9	100,0	100,0	100,0
Motor vehicles and fuels (NACE 50)	363,6	393,1	422,3	459,4	8,1	7,4	8,8	14,3	14,5	14,5
Wholesale (NACE 51)	1 540,2	1 642,3	1 732,5	1 889,4	6,6	5,5	9,1	59,7	59,5	59,5
Retail trade (NACE 52)	683,8	714,9	758,3	824,3	4,5	6,1	8,7	26,0	26,0	26,0
Of which large enterprises *)	290,6	310,8	340,2	378,5	7,0	9,5	11,2	11,3	11,7	11,9
other businesses	393,2	404,1	418,1	445,9	2,8	3,5	6,6	14,7	14,4	14,1

Source: Czech Statistical Office (quarterly survey)

*) Companies with 100 or more employees, including hypermarkets and supermarkets

The sales acceleration was affected by the simultaneous functioning of multiple factors:

- **growing purchasing power of households** resulting from the increase in real income and enhanced employment, as well as from the fast-growing volumes of other types of income;
- **tend to increase the consumption** is being raised by tempting offers of the credit forms of sales, low interest rates on savings deposits, wide offer of goods of both domestic and foreign origin and modest price growth in durable goods;
- **rapid growth in sales of durable goods**, in particular, furniture, white techniques and electronics can be put into the context of furnishing cycles of households, innovation assortment and fitting-out range of newly completed dwellings;
- both **business and public sector are strongly involved** in sales of the trade sector whose purchasing activities are supported by high economic growth rates;

- booming tourists income keeps purchases on the domestic market very attractive for non-residents in many directions. The specific form of the **"shopping tourism" phenomenon** is resulted in many border areas;
- the attractiveness of purchasing and consumption increase the **dynamic development of business centres** (such as Novodvorská Plaza, Šestka in Prague 6, Palladium, the next step Tesco Letňany), which are offering also entertainment, catering and other options in addition to business services;
- in addition to coverage of the mass consumption in the normal commercial network, even the **utmost demand for extremely high quality and luxury goods** resulting from the differentiation of income and consumption possibilities, is increasingly being satisfied.

Sales increased in all areas of trade

Revenues from the sale of goods and services reached at current prices, without VAT, 3 173.1 billion CZK in 2007 and the year-on-year outcome **increased by 8.9 %**. They increased in all areas of trade, the most in the **wholesale** by 9.1 %, in the **retail trade** by 8.7 % and in the **motor sport segment** by 8.8 % (see details in the Table V.1.1).

A high **growth in the wholesale sales** (NACE 51) stems from its intermediary function as well as from the high import volumes and results the strong pace of overall economic development.

The increase in sales of motor sport segment (NACE 50) related to both the revenue growth for sale of new and used cars (see table V.1.2.), and sales for the repair and maintenance of motor vehicles.

Table V.1.2 Development in the market of passenger cars and utility vehicles under 3.5 tonnes (first registration)

		Number of pieces		Difference (in pieces)	Growth (+), Decline (-) in %
		2006	2007	2007 – 2006	07/06
Passenger cars and small utility vehicles up to 3,5 t in total	new	173 478	194 580	21 102	12,16
	used	191 159	223 488	32 329	16,91
of which: passenger of which Škoda company	new	123 987	132 542	8 555	6,90
	used	51 833	49 094	-2 739	-5,28
small utility vehicles	new	183 143	212 869	29 726	16,23
	used	49 491	62 038	12 547	25,35
		8 016	10 619	2 603	32,47

Source: Statistics of the Association of importers of cars, the Association of Automotive Industry

Both large and small businesses prospered in the retail trade

A rate of growth of the retail sales (NACE 52) increased by 2.6 p.p. to 8.7 % p.a.. A rapid growth continued in the retail sales of the large enterprises with more than 100 employees (11.2 % p.a.), which include, in particular, supermarkets and hypermarkets. Small shops, which still continue to maintain its viability, experienced an increase in sales of 6.6 %, which is roughly the double growth against the previous years.

Extraordinary fall of business margin

Throughout the year, the **outcome, including trading margins** in the industry increased by 2.2 %, the power consumption by 2.5 % and the **book value added** by 2.0 %. The volume of the **business margin** declined by 2.2 %. The **average rate margins** throughout the industry decreased year-on-year by 1.6 % to 14.6 %, in the **motor sport segment** decreased by 1.4 p.p. to 8.9 %, in **wholesale** trade declined by significant 2.3 p.p. to 12, 2 % and in **retail trade** by 0.3 % to 22.4 %.

Notwithstanding that the wages in the trade sector are growing, they are yet short of the average in the national economy

An **average number of employees in the year increased** mainly due to the growing business activities by 5.1 % to 536.9 thousands p.a. It grew in all areas of trade, the most in the wholesale (by 7.5 %) and the least in the motor sport segment (1.3 %). The **average nominal monthly wage** in the trade sector increased year-on-year by 8.5 % (most in the retail trade - by 9.2 %, least in the motor sport segment - by 7.2 %). Its amount of CZK 19 365 attains 96.1 % of the average wage in the national economy.

The market share of the large business companies grows...

The **market share** of the large business enterprises (with 100 employees or more) **in the total revenues** has still been **increasing**, namely in all segments of the trade sector (Table V.1.3). This gradual process has been lasting for many years, proving that large organizations are more likely to survive the competitor's fight more easily than small traders. The large enterprises are involved in the largest share in the retail trade (45.9 %).

Table V.1.3 Development of the market share of commercial enterprises with 100 or more employees in the total sales in % (in current prices excluding VAT)

	2000	2001	2002	2003	2004	2005	2006	2007
- motor vehicles, fuels (NACE 50)	23,7	26,0	24,9	25,7	29,3	28,3	30,5	33,7
- wholesale (NACE 51)	24,0	26,3	27,0	28,3	30,0	30,9	30,3	31,7
- retail trade (NACE 52)	38,0	39,8	39,5	39,5	42,5	43,5	44,9	45,9
Trade in total (50, 51, 52)	27,6	29,8	30,2	31,1	33,2	33,8	34,1	35,7

Source: CZSO

...most companies under the foreign control

Within the large business organizations with 100 or more employees, in particular **companies under foreign control** continued to develop dynamically (sector 11003). Their share of sales of major companies rose from 27 % in 1998 to nearly 63 % in 2007. These companies establish themselves in all areas of trade and have the strongest position in the **retail trade**, where in 2007, under the large enterprises, accounted for more than 81 % of the sales volume. A **prevalence of the multinational firms**, compared to the domestic business enterprises, results mainly from their financial strength and business experience. Comparing characteristics figures of some retail companies under foreign control with the domestic firms with 100 employees are shown in the Table V.1.4. The average outpaces in the sales growth and volume of attributable sales per employee is particularly significant for the multinational enterprises.

Table V.1.4 Domestic trading enterprises and foreign owned enterprises with 100 or more employees (NACE 52)

		2005	2006	2007	Change in %		Share in %		
					06/05	07/06	2005	2006	2007
Number of employees (in thousands)	Total	108,7	110,7	116,1	1,8	4,9	100,0	100,0	100,0
	Domestic	35,7	36,1	36,6	1,2	1,5	32,8	32,6	31,5
	Multinational	73,1	74,6	79,5	2,1	6,6	67,2	67,4	68,5
Volume of sales in current prices, excluding VAT (bill CZK)	Total	298,3	327,4	363,7	9,8	11,1	100,0	100,0	100,0
	Domestic	62,7	62,4	66,5	-0,6	6,7	21,0	19,0	18,3
	Multinational	235,5	265,1	297,2	12,5	12,1	79,0	81,0	81,7
Volume of sales per employee (in thousands)	Domestic	1 759,8	1 728,2	1 817,3	-1,8	5,2	x	x	x
	Multinational	3 224,1	3 553,4	3 738,5	10,2	5,2	x	x	x
Business margin in %	Domestic	21,4	22,8	22,6	x	x	x	x	x
	Multinational	21,2	22,8	24,5	x	x	x	x	x

Source: CZSO

The enterprises under a foreign control reached more than 81 % of the proportional share on the **retail sales** within the frame of a big entrepreneurs.

The concentration in the retail trade continued

In 2007 the development in the retail trade of fast moving consumer goods was characterized by the continued expansion in addition to the **process of corporate mergers**, launched at the turn of the years 2005 and 2006 and designed to a further increase in the concentration (taking over the business chain Delvita by the REWE group). The revenues of the **10 largest trading companies** on the Czech market increased year-on-year by more than 30 billion CZK and their market share increased by three per cent to 66 %. A sequence of the TOP 10 in 2007, according to the amount of sales is shown in the Table V.1.5.

Table V.1.5 Sequence of the ten largest companies in the Czech Republic in 2007 according to the turnover reached in billion CZK including VAT

Order	Company / group	Chain (number of retail stores)	Revenues in bill. CZK		Change
			2006	2007	
1.	Schwarz ČR (group)	Kaufland, Lidl	45,5*	51,1*	5,6
2.	Ahold Czech Republic, a.s.	Albert, Hypernova	38,5*	42,0*	3,5
3.	Tesco Stores ČR, s.r.o.	Tesco hypermarket, Tesco OD, supermarket	36,0*	42,0*	6,0
4.	Makro Cash&Carry ČR, s.r.o.	Makro	38,3*	39,3*	1,0
5.	REWE ČR (group)	Penny Market, Billa, Delvita	25,8*	31,6*	5,8
6.	Globus ČR, k.s.	Globus, Baumarkt Globus	20,5	23,0	2,5
7.	Tengelmann ČR (group)	Plus, OBI	19,5*	20,5*	1,0
8.	GECO TABAK	Tobacco, newspapers	14,9	17,7	2,8
9.	Spar ČR (group)	Interspar, Spar	12,0*	14,0*	2,0
10.	PEAL, a.s.	Tobacco	6,8	8,0	1,2

Source: INCOMA Research, * estimate

V.2. Final household consumption

The year 2007 was record-breaking in terms of growth in retail sales

The consumer's behaviour significantly affects the economic growth. The consumers demand in the internal market is usually **characterized by the development of the physical volume of sales** (in constant prices) in the **retail trade** (NACE 52) and **motor sport segment** (NACE 50). In summary, this volume in **2007 increased by 7.7 % p.a.**⁹ while **sales in the motor segment increased by 9.6 % and in the retail trade by 6.8 %**. This is the **highest growth rate** since the beginning of a comparable time series since 1997. More detailed figures are shown in the Table V.2.1.

Table V.2.1 Development of retail sales, including automotive segment
(NACE 50 and 52, changes in %, constant prices including VAT)

	2004	2005	2006	2007				
				1.Q	2Q	3Q	4Q	year
Retail trade, motor vehicles and fuels (NACE 50 and 52)	2,5	4,0	6,5	9,8	7,9	6,7	6,8	7,7
- Retail trade (NACE 52)	3,0	3,8	6,5	8,7	7,3	6,4	5,2	6,8
- Motor segment (NACE 50)	1,5	4,3	6,5	12,2	8,9	7,4	10,4	9,6
of which: motor vehicles (NACE 50.1-50.4)	0,9	4,9	7,3	14,2	12,4	9,3	13,5	12,4
fuels (NACE 50.5)	2,6	3,4	5,0	8,6	2,7	4,4	4,6	4,9

Source: Czech Statistical Office (monthly survey)

Different development in food and non-food products sales

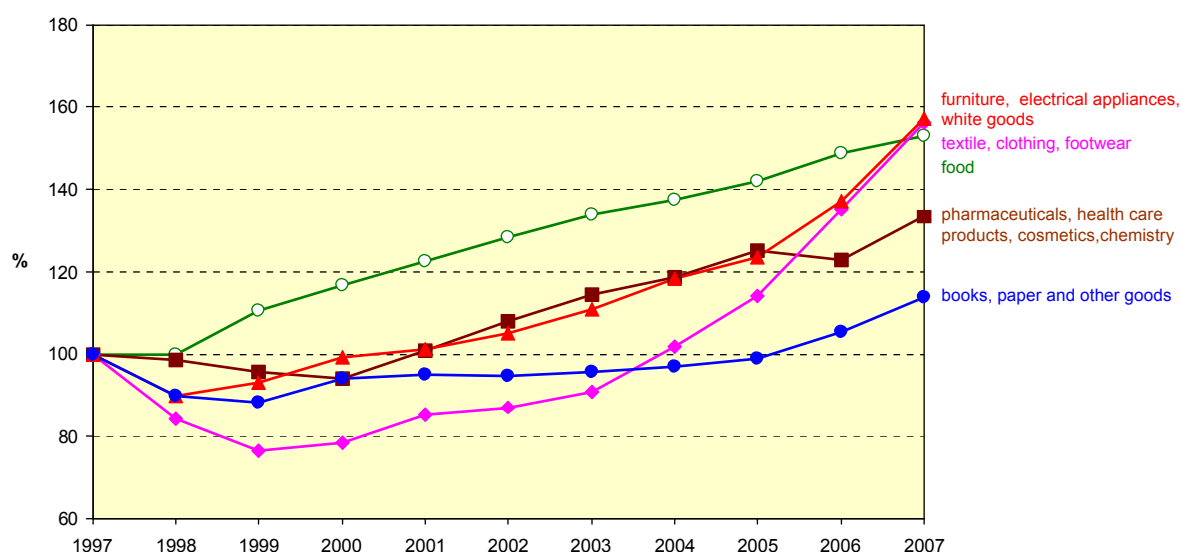
The retail outlets with an increased **prevalence of food range** showed the year-on-year increase in the sales volume of about 2.8 % in 2007 and its rate of growth decreased by 2.0 p.p., compared to the previous year. The retail shops with a **range of non-food sales** increased the volume of sales by 9.6 %, which represents a growth acceleration of 1.8 p.p.. The highest year-on-year growth of 15.7 % was reached by the **textiles, clothing, and footwear and leather goods stores**; an increase of 14.5 % was achieved in the stores with **furniture and electronics**.

Retail sales have been rising since nine years

The **physical sales volume has been increasing** continuously since 1999. The purchasing activity of consumers in recent years, however, was greatly differentiated according to the individual **line of goods groups** (development in the years 1997 to 2007 is shown in the Chart No V.2.1). It is arguable that while the sale of **food**, after a slight downturn, grew evenly since 1998, the sale of **non-food goods** showed different developments for every line of goods in the range. The highest rates growth in 2007 was indicated for sales in the range of "**textiles, clothing and footwear and furniture, electronics and hardware**." After a downturn in 2006, sales increased again in the "**pharmacy, medical supplies, cosmetics and chemistry goods**", sales "**of books and paper goods**", which overcome declines as late as in 2006 also increased substantially in 2007.

⁹ The source of these information is a monthly survey index of sales (including VAT), which is implemented by the Czech Statistical Office and published in form of express information. The numerical values of these investigations may differ in the accumulation of a quarter from the outputs of the quarterly surveys of sales.

Figure V.2.1 Development of retail sales according to the range of assortment since 1997
(data for the year, NACE 52.1 to 52.4, in constant prices, including VAT, the year 1997 = 100)



Source: Czech Statistical Office, chart MIT

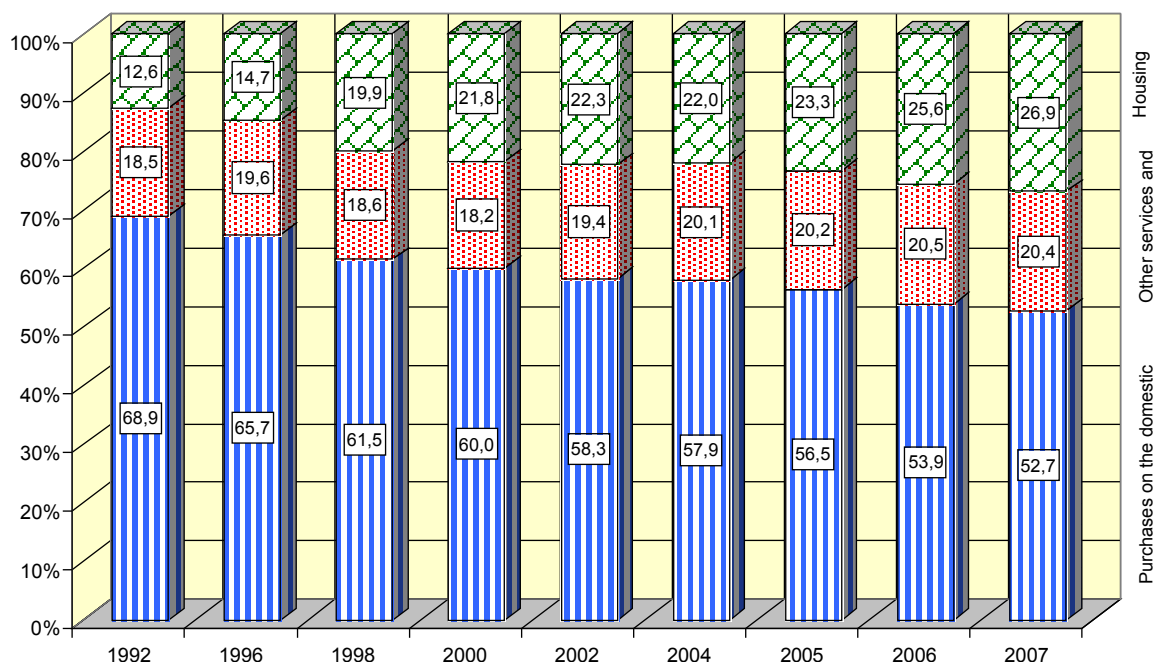
Increasing pensions allow an increase in consumption, savings, however, fail to grow

Development of sales is largely derived from the development of household income and is associated primarily with the growth of wages. It is typical for the behaviour of the Czech households over the past decade that a higher consumption substantially absorbed the growth of their revenues. **The volume of savings** in the every year remains roughly the same and both the **income and consumption** are increasing by the nearly consistent pace. The growth in income is thus not resulted in increase of the volume of household savings. Stagnating volume growth in savings, while the earnings rises, leads to a decline in the revenue savings rate (indicates the proportion of the volume of savings and disposable income in %). While at the mid-nineties the Czechs belonged to the most saving in Europe (the rate of savings in the Czech Republic exceeded 14 % and the European average fluctuated around 11 %), currently the rate of savings in the Czech Republic is lower than in other European countries (between 1995 and 2004 in the Czech Republic dropped by 6.6 p.p., while in European countries, only by 2.2 p.p.). In 2006, the savings rate was at the level of 6.6 %, in 2007 fell to 5.1 %.

The proportion of household expenditure for the purchase in the internal market was continuously declining at the expense of investment in housing

A growing purchasing power of households under the consumer basket is not evenly used. A **share of expenses for housing**, including payments for the supply of energy, water and other services, in addition to rent payment, **has been continuing to grow**, in particular (primarily a consequence of the price increasing). A number of households, which repaid mortgages and other loans in connection with investments in securing their own, housing, grows, while the share of other expenses, which run the household outside the internal market (such as the telecommunications services, cable TV, Internet, etc.) increases, too. These changes in the structure of households expenditure cause that the **share of expenses for purchases of goods in the internal market has therefore gradually been slightly weakening** (see the Chart No.V.2.2).

**Figure.V.2.2 Development of the structure of selected foodstuffs consumption
(the average consumption per capita) in the years 1999 to 2007 (%)**



Source: Czech Statistical Office - statistics on household budgets, MIT chart

The share of imports of goods year-on-year slightly decreased

Although there are no direct statistical data about the origin of the goods on the consumer market, from the MIT calculations can be inferred that **the proportion of the goods of foreign origin** in the total sales decreased by 0.3 p.p. to 40.0 % p.a.. It shows that after the long-term growth of the share of imported foreign goods, the consumer market has been relatively saturated.